APRA

ANNUAL REPORT 2003

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

**Our 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.

**Our values** are underpinned by the highest standards of individual and corporate integrity, as well as by flexibility, openness and accountability.

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

The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the 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 $1.7 trillion in assets for 20 million Australian depositors, policyholders and superannuation fund members.



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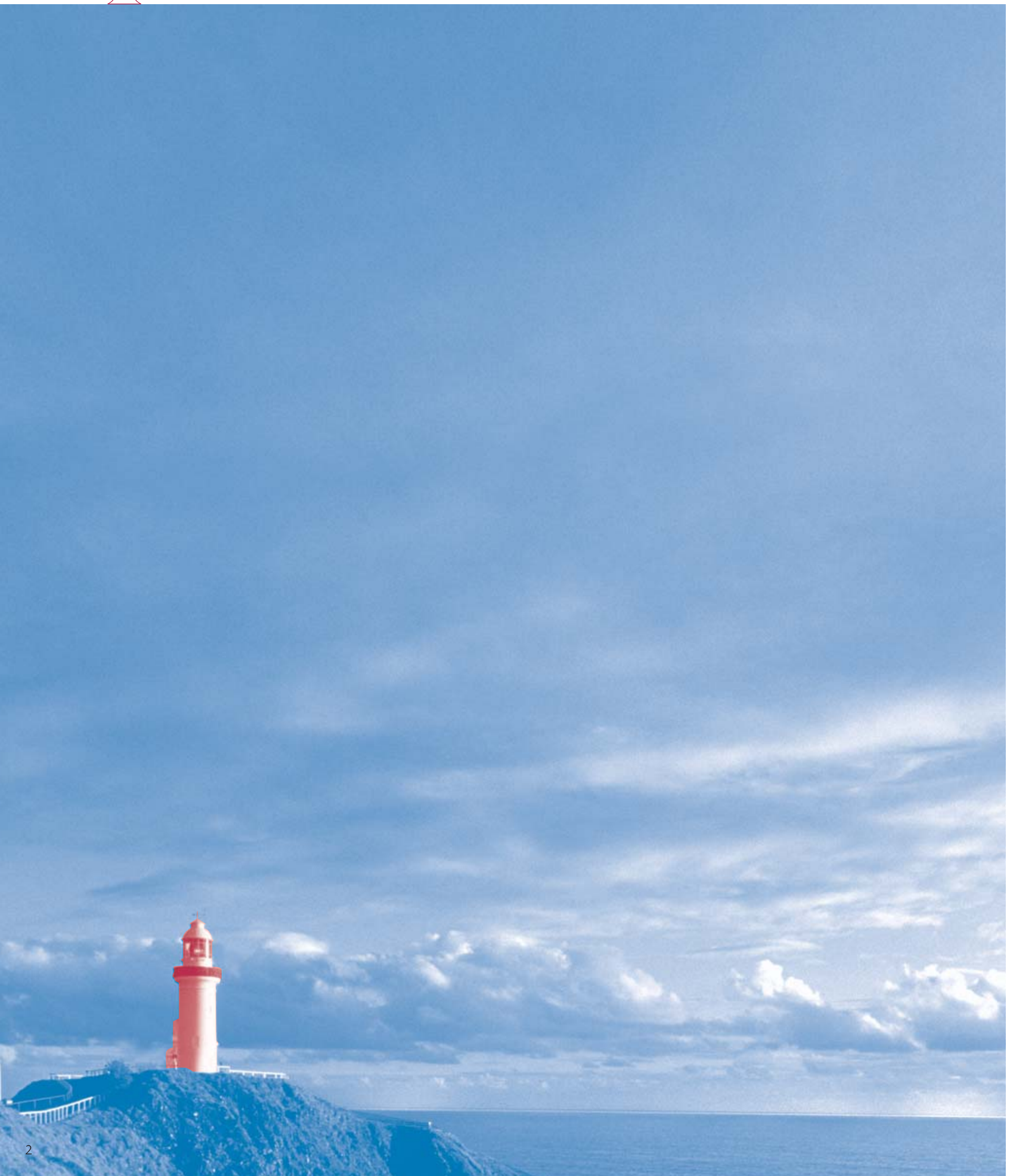
# From the Chairman



During the past year, the key features of the domestic economic environment that impacted on APRA's role as prudential regulator were the further rapid increase in lending for housing – sustaining the momentum of property price rises – and the weakness of the share market. At the same time, Australia's strong growth performance, though easing moderately in pace, continued to underpin the health of financial institutions.

The weakness in the Australian share market over much of 2002/03 echoed international equity markets, which suffered renewed sharp falls in a climate of geo-political tensions and uncertainty about global growth prospects. The deterioration in investment returns took its toll on the global insurance industry, particularly the reinsurance sector, which suffered a depletion of capital and a consequent reduction in capacity to absorb risks.

APRA's main focus for the year was to ensure that pressures on supervised sectors created by these forces, domestic and international, did not threaten the interests of APRA's beneficiaries. Accordingly, APRA reviewed the property lending practices of banks and other authorised deposit-takers and has been testing how these institutions would fare if there were to be a significant correction in the property market. APRA assessed the impact of weak investment markets on the insurance sector and on defined benefit superannuation funds in particular. APRA also sought to satisfy itself that domestic insurance companies were insulated from weaknesses in associated foreign operations, whether parent or subsidiary.

The Australian financial system has stood up well to the pressures. Profitability and capital adequacy in the deposit-taking sector remained strong while the general insurance industry experienced a hardening in the premium cycle. Low earnings on superannuation fund investments, however, contributed to funding deficiencies in some defined benefit superannuation schemes and reduced fee income for life insurance companies.

## The supervisory framework

In APRA's program to upgrade the supervisory framework, 2002/03 was a year of consolidation. Major reforms to general insurance regulation came into effect on 1 July 2002 and were bedded-down during the year. The new supervisory regime has put the general insurance sector on a much sounder prudential footing, but the reform process has further to run.

Another major reform for which APRA has begun to prepare is the Government's initiative to strengthen the safety of superannuation. This introduces a comprehensive licensing regime and a substantial upgrading of prudential requirements for superannuation entities. The new regime is due to commence in 2004 and APRA has commenced preliminary consultation with industry. Work has also progressed on new statistical collections covering the operations of superannuation funds.

APRA continued to work closely with the Basel Committee on Banking Supervision, which is leading international efforts to reform capital adequacy requirements for banks. The final shape of the Basel proposals for more risk-sensitive capital measures will be known later in 2003, and APRA is committed to extensive consultations with industry participants in implementing these important reforms in Australia. During the year, APRA introduced new prudential standards for capital adequacy in banking groups and for Specialist Credit Card Institutions.

A new regime of prudential regulation for providers of medical indemnity insurance was also developed in 2002/03 to address longstanding structural deficiencies in this sector.

## APRA's capabilities

APRA's effectiveness depends not just on the supervisory framework, which has received considerable attention over recent years, but also on the strength of its processes and procedures and on its staff and other internal resources.

On these scores, good progress was made during the year. APRA's more sophisticated system for risk-rating supervised financial entities was progressively rolled-out and, by year-end, over 800 entities accounting for almost 90 per cent of APRA-supervised assets had been rated. This new system acts as an early warning of emerging distress and strengthens the processes by which problems in high-risk institutions are escalated to senior management. APRA has also been developing more rigorous business planning and performance measurements.

APRA continues to give high priority to building up the skills and experience of its staff through its recruitment and training programs, and it is pleasing that APRA has been able to attract experienced people from industry in specialist areas. APRA's staff numbers have now reached a little above 500, an increase of 19 per cent over the previous year.

## The HIH Royal Commission

The release of the Report of the HIH Royal Commission in April was a significant event for APRA. The Report was critical of APRA's supervision of HIH. At the same time, it emphasised that APRA did not cause or contribute to the collapse of the insurer, nor could it have taken steps to prevent the failure.

APRA cooperated openly and candidly with the Royal Commission, a fact acknowledged by the Commissioner. In addition to appearances by a number of staff as well as by the Chairman of the Board and the Chief Executive Officer, APRA provided a submission on future policy directions for prudential regulation of the general insurance industry. It also made available to the Royal Commission a copy of a report by John Palmer, an international expert on prudential regulation, whom APRA had earlier commissioned to review its role in the collapse of HIH. The Palmer Report made a number of recommendations regarding APRA's operations and its powers and resources.

APRA broadly accepts the Commissioner's account of its shortcomings in the supervision of HIH in 1999 and 2000, much of which was in line with the findings of the Palmer Report. According to the Commissioner, the key reasons for those shortcomings were a weak regulatory framework for general insurance, a shortage of experienced staff during APRA's establishment phase and undeveloped internal processes within APRA.

The Commissioner recognised that APRA had already made substantial improvements to the regulatory regime in the period since HIH's collapse through, for example, the introduction of more comprehensive prudential standards and the progressive upgrading of APRA's supervisory capacities as it moved beyond its establishment phase. From APRA's perspective, there were three particularly significant aspects of the Royal Commission's Report. The first was its recommendations for steps to improve the governance and supervision of insurance companies, so as to reduce the likelihood of another HIH-like episode. The second related to APRA's supervisory style, with the recommendation that APRA develop a more sceptical, questioning and, where necessary, aggressive approach to its prudential supervision of general insurers. The third was the recommendation for a new governance structure for APRA.

The Government has already acted on this last recommendation and has recently delivered its detailed response to the other recommendations in the Royal Commission's Report. Almost without exception, the recommendations in the Report relating to APRA endorse changes that APRA has now put into place or is currently implementing or developing. These include enhancements to prudential standards to permit the supervision of insurance groups on a consolidated basis, as well as the development of staff skills and experience, more sophisticated systems for risk-rating supervised entities and appropriate supervisory methodologies.

## The challenges ahead

Going forward, APRA must remain alert to signs of any downturn in economic activity and any emerging stresses in financial markets or industry sectors. While Australia has enjoyed a very healthy economic environment for the past decade, this trend should not be taken for granted.

From the perspective of a prudential supervisor, the healthy economic climate has both positive and negative implications. On one side, strong economic activity generally allows financial institutions to prosper and build up their financial strength. On the other, continued prosperity can mask weaknesses in an institution's business model or appetite for risks. APRA has been emphasising to supervised entities the need to maintain prudent practices and to ensure that their risk management processes are not just set for fair weather. This caution applies particularly to any deposit-taking institutions that are lending, or tempted to lend, aggressively into over-heated property markets. In a dynamic and competitive financial system such as Australia's, financial institutions must also avoid chasing reductions in cost at the expense of proper corporate governance, risk management and internal controls, or chasing increases in revenue by venturing into activities in which they have little experience or which bring much increased risks. APRA has been pursuing these issues over the past 12 months and they will remain a point of focus in the year ahead.

APRA also needs to ensure that its supervisory and enforcement powers are adequate to deal with the continually changing nature of the financial system. APRA is in regular dialogue with the Government on financial developments and their possible implications for the prudential supervision framework and APRA's legislative powers. In this context, APRA has been undertaking a comprehensive stock-take of its powers so as to identify significant gaps and inconsistencies, and that stock-take has suggested a range of potential enhancements that would increase APRA's effectiveness. One priority area, from APRA's perspective, is ensuring that its powers are consistent with its mandate as an integrated prudential regulator and support its ability to deal with financial conglomerates.

Mr Ross Jones, Dr John Laker, Mr Steve Somogyi.

Finally, APRA must be mindful of changes in the broader regulatory environment, and ensure that its objectives and practices are consistent with domestic and global developments in areas such as corporate governance and international accounting standards.

## Under new management

On 1 July 2003, a new three-person Executive Group took the place of APRA's previous non-executive Board and Chief Executive Officer. The HIH Royal Commission had argued, and the Government accepted, that an enhanced governance structure for APRA was needed to provide clearer and sharper lines of accountability.

The new Executive Group – Ross Jones (Deputy Chair), Steve Somogyi and myself – are committed to restoring community confidence in APRA as a vigilant, vigorous and effective prudential regulator. In doing so, we acknowledge the significant contribution made by the APRA Board and the Chief Executive Officer, Graeme Thompson, in laying the foundations for a world-class regulator and melding a cohesive unit from predecessor bodies, at a time when there was no tried-and-tested blueprint for an integrated supervisory agency. We intend to build on these foundations, while absorbing the lessons from the HIH failure. Our immediate priority, as the Royal Commission recommended, is to review APRA's organisation structure and resources to ensure that APRA is up to the challenges ahead.

Our task will be made easier by the dedication and professionalism of APRA's staff. We thank all of them for their hard work and resilience during what was a difficult year for APRA. We also record with sadness the death of Bill Gole, General Manager (Coordination, Rehabilitation and Enforcement) on 21 June 2003. Prior to joining APRA, Bill was Chief Executive of the NSW Financial Institutions Commission, one of APRA's predecessor agencies. He was an important and influential member of APRA's management team during its formative period and his retirement on ill-health grounds in August 2002 was a considerable loss to his colleagues and to the organisation.

*Dr John F. Laker*
Chairman

# 2 APRA's supervisory approach

APRA's approach to ensuring the continued protection of Australian depositors, policyholders and superannuation fund members has three essential elements:

- a robust supervisory methodology for identifying and assessing weaknesses in a supervised entity;
- constant oversight of supervised entities including consultations and on-site visits; and
- supervisory intervention and enforcement of prudential standards and regulations, where necessary.

APRA has substantially upgraded its risk assessment capabilities and has significantly increased the intensity of its supervision over the past two years, concentrating particularly on the superannuation and general insurance sectors.

## Supervisory methodology

In October 2002, APRA introduced new risk assessment and supervisory response tools known as the Probability and Impact Rating System (PAIRS) and the Supervisory Oversight and Response System (SOARS). Under the PAIRS system, supervised financial institutions are classified according to the probability that the institution may be unable to honour its financial promises to depositors, policyholders and superannuation fund members. APRA assesses the likelihood of each institution's failure based on the inherent risk of the institution, balanced by its management and controls and the capital support available. This 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 is used to determine how supervisory concerns based on PAIRS risk assessments should be acted upon (see table on next page).

APRA supervises over 11,000 entities and, of these, some 3,000 are suitable for PAIRS rating. This total excludes Small APRA Funds (SAFs), which are assessed via a rating of the Approved Trustee responsible for the fund. By June 2003, 825 entities had been PAIRS rated. They included some 100 entities rated as 'Extreme' or 'High' impact because of their size; these entities represent around 80 per cent of APRA-regulated assets and were the first group to be rated. APRA expects to complete an initial assessment of all relevant institutions within two years.

A PAIRS panel within APRA reviews the ratings of each 'Extreme' and 'High' impact entity at least once a year. This is an important qualitative process involving senior staff from across the organisation and it acts to ensure consistent application of the PAIRS assessment framework. Statistical analysis also identifies ratings that appear out of line and these are referred to relevant supervisors and managers for re-consideration.

APRA also receives data and risk-rating information from four credit rating companies, a corporate governance advisory service and a data warehouse for Australian superannuation funds. These services augment APRA's in-house PAIRS risk model and support APRA's transition to a more analytical, data-driven supervisory approach.

Timely and accurate financial statistics are vital to APRA's ability to supervise efficiently and undertake rigorous PAIRS ratings. APRA has stepped up its efforts to ensure that supervised entities meet their statutory responsibilities in this area. A new reporting regime for general insurance was introduced in September 2002. This followed the overhaul of the reporting regime for authorised deposit-taking institutions that commenced in September 2001, and precedes the planned introduction of new comprehensive reporting requirements for the superannuation industry in mid-2004. The expanded collection on superannuation will cover balance sheet, cash flow and cost data.

# PAIRS AND SOARS

### Probability and Impact Rating System (PAIRS)

PAIRS provides the framework for a continuing cycle of risk and impact assessment for each supervised entity. PAIRS assesses the probability that an entity could fail over the medium term, and the potential impact on the Australian financial system should such a failure occur.

Supervisors conduct PAIRS risk assessments using standardised risk and risk mitigation analysis, taking into account the entity's business environment, internal governance, risk management and control structures and capital adequacy. Within the PAIRS probability rating, 'Extreme' entities are those entities with a high likelihood of incurring losses that would lead to a default on their commitments to Australian beneficiaries.

PAIRS impact assessments are based on measures of relative size within each industry sector and endeavour to capture the direct impact of an entity's failure on its customers and other creditors as well as the potential for adverse systemic consequences.

Within the PAIRS impact rating, 'High' and 'Extreme' impact entities are those entities whose failure would generate a potentially high economic cost because of their size and asset base, taking into account the direct impact on beneficiaries and any indirect effects. Entities in these categories are normally the larger financial institutions, and the PAIRS impact rating carries no connotation that these entities have a higher risk of failure.

### Supervisory Oversight and Response System (SOARS)

SOARS identifies the necessary level of supervisory oversight that should be applied to an entity as a result of its PAIRS assessment. There are four supervisory stances in SOARS:

- Normal;
- Oversight;
- Mandated Improvement; and
- Restructure.

'Normal' entities are subject to routine information-gathering mainly from statistical returns and on-site visits. 'Oversight' entities are not at material risk of failure, but some aspect of their risk position requires more extensive examination by APRA.

'Mandated Improvement' entities lie outside APRA's tolerable risk range. Although these institutions are unlikely to fail, APRA intervenes vigorously at this level to ensure that such entities deal with the problems identified. 'Restructure' entities have lost APRA's confidence, and APRA will take action to transfer the business to stronger hands, while protecting beneficiaries from any potential losses.

The relationship between PAIRS ratings and the four broad levels of supervisory intensity is shown below.

**'SOARS' supervisory stance**

| PAIRS impact rating | PAIRS probability rating: Low | Medium | Medium | High | Extreme |
|---|---|---|---|---|---|
| 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 |

## Supervisory activity

One measure of the increase in APRA's supervisory intensity over the past two years, compared with its earlier formative years, is the marked rise in direct contacts with supervised entities through on-site visits, consultations and tri-partite meetings (involving the supervised entity and its external auditor). The number of such contacts in 2002/03 was a little lower than the previous year, with the completion of the re-authorisation process for general insurers and a fall in the number of supervised institutions in the superannuation sector. However, it was still some 23 per cent above the level of two years earlier.

## Enforcement

APRA's supervisory approach gives priority, wherever possible, to protecting beneficiaries in advance of potential problems. Against this background, APRA's enforcement activities during 2002/03 focussed on preventative actions, such as removing trustee boards from the management of troubled superannuation funds and disqualifying unsuitable personnel from future roles in the superannuation industry. Reflecting APRA's stronger enforcement culture, enforcement actions, particularly in the superannuation industry, almost doubled. The number of institutions requiring intense management by APRA fell from 180 to 168; most of these are superannuation funds in the process of winding-up operations.

### APRA visits, consultations and tripartite meetings

| Entity | 2001/02 | 2002/03 |
|---|---|---|
| ADIs | 235 | 263 |
| Friendly societies | 16 | 26 |
| General insurers | 141 | 87 |
| Life insurers | 7 | 10 |
| Approved Trustees | 75 | 79 |
| Superannuation funds | 998 | 802 |
| Conglomerates | 26 | 42 |
| **Total** | **1,498** | **1,309** |

### Enforcement actions undertaken during the year

| | ADIs | | Superannuation | | General insurance | | Life Insurers | | Friendly societies | | Other[1] | | TOTAL | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2002 | **2003** | 2002 | **2003** | 2002 | **2003** | 2002 | **2003** | 2002 | **2003** | 2002 | **2003** | 2002 | **2003** |
| AAT/Federal Court review | | | | 10 | | 1 | | | | | | | | 11 |
| Amendment of IOA[2] | | | | 9 | | | | | | | | | | 9 |
| Appointment of Acting Trustee | | | | 3 | | | | | | | | | | 3 |
| Appointment of liquidator/inspector | 1 | | 3 | 13 | 2 | 2 | | | | | | | 6 | 15 |
| Civil litigation | | | | 1 | | 1 | | | | | | | | 2 |
| Directions | 3 | 21 | 14 | 33 | 4 | 9 | | 2 | 3 | | 10 | 13 | 34 | 78 |
| Disqualification of auditors/directors | | | | 16 | | | | | | | | | | 16 |
| Enforceable undertaking | 2 | | 8 | 9 | | | | | | | | | 10 | 9 |
| Follow-up delayed contributions | | 13 | 50 | 44 | | | | | | | | | 50 | 57 |
| Investigation action | | 1 | | 6 | | | | | | | | | | 7 |
| Other action | 4 | 10 | | 5 | 2 | 7 | | | | 17 | 6 | | 12 | 39 |
| Prosecution | | | | 26 | | | | | | | | | | 26 |
| Refer to other agency/police | 2 | 1 | 15 | 44 | 2 | 6 | | | | 1 | | 6 | 19 | 58 |
| Removal of trustee/ withdrawal of IOA/ revocation | | 8 | 1 | 6 | | | | | | 1 | | | 1 | 15 |
| Show cause letter | 2 | 1 | 16 | 36 | 49 | 4 | | 1 | | 1 | | | 67 | 43 |
| **Total** | **14** | **55** | **107[3]** | **261** | **59[3]** | **30** | | **3** | **3** | **20** | **16** | **19** | **199** | **388** |

1 Includes institutions not regulated by APRA suspected of conducting unauthorised financial activity.
2 Instrument of Approval.
3 Revised from *APRA Annual Report 2002*.

**Institutions supervised by rehabilitation and enforcement**

| | Number as at 30/6/02 | Institutions added during the year | Institutions returned to regional supervision teams | Institutions transferred/ wound-up | Number as at 30/6/03 |
|---|---|---|---|---|---|
| ADIs | 15 | 3 | 4 | 3 | 11 |
| SIS institutions | 43 | 24 | 22 | 8 | 37 |
| Friendly societies | 9 | 1 | 5 | 2 | 3 |
| General insurers | 4 | 14 | 3 | 7 | 8 |
| SIS institutions winding-up | 91 | 214 | 0 | 205 | 100 |
| Other [1] | 18 | 23 | 0 | 32 | 9 |
| Total | 180 | 279 | 34 | 257 | 168 |

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

APRA referred 21 cases to the Director of Public Prosecutions for late or non-lodgment of the 2001/02 annual superannuation fund returns. This was an increase over the previous year (13 cases), but overall compliance has improved from 36 per cent of returns received on time in 2000/01 to 93 per cent for 2002/03.

In August 2002, APRA froze the assets of and commenced a formal investigation into Colors Pty Ltd Superannuation Fund (Colors), a Melbourne-based employer-sponsor superannuation fund in the media and advertising industry. The trustee had made loans to the employer-sponsor, which had been subsequently placed into liquidation by the South Australian Supreme Court. APRA's investigation found Colors had failed to comply with the in-house asset provisions of the *Superannuation Industry (Supervision) Act 1993* (SIS Act). These provisions generally prohibit a fund investing more than five per cent of assets in the employer-sponsor, so as to prevent workers' retirement benefits being held hostage to the fortunes of their employer-sponsor. In September 2002, APRA removed Colors Investment Management Pty Ltd as trustee and appointed an Acting Trustee. APRA has disqualified the four directors of the former trustee from any future key role in superannuation on the grounds that they failed the 'fitness and propriety' test in the SIS Act.

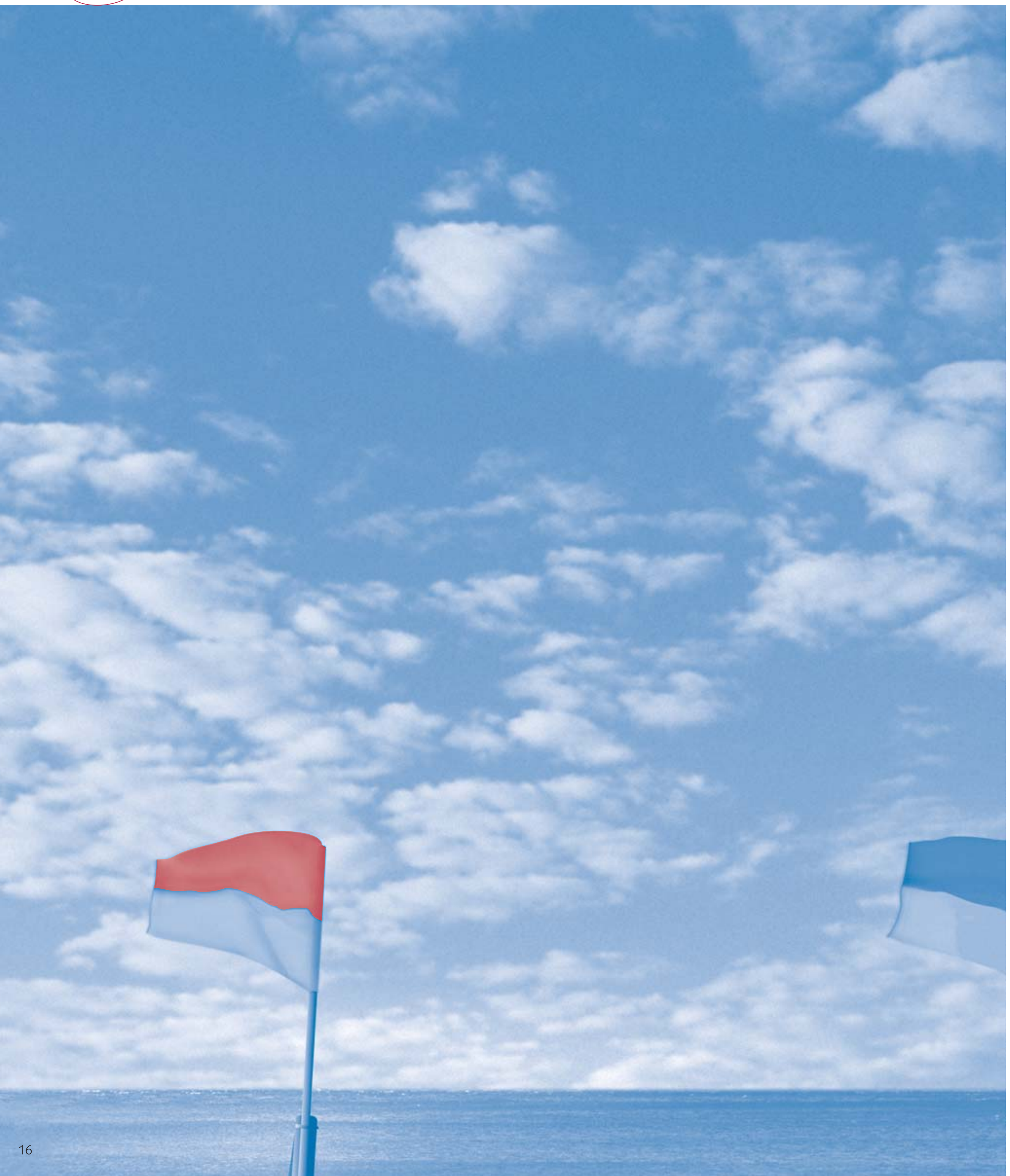
In November 2002, APRA announced that Trust Company of Australia Limited had taken over trusteeship of the retail superannuation funds previously managed by Beacon Funds Management Limited (Beacon), and that its Approved Trustee licence had been revoked. Beacon had been the Approved Trustee of various public offer funds and a number of SAFs. In August 2002, following a material breach of its $5 million regulatory capital requirement as a result of derivatives trading, APRA had received an enforceable undertaking from Beacon to transfer its superannuation business to a new Approved Trustee.

In February 2003, APRA announced that Melbourne-based financial group, IOOF, would take over AM Corporation Limited's superannuation and insurance business, including around $2.8 billion of superannuation managed by Approved Trustee, LifeTrack Management Limited (LifeTrack). In May 2002, APRA had commissioned a formal investigation into LifeTrack's investments in traded life insurance policies and, in October 2002, accepted an enforceable undertaking from AM Corporation to proceed with a sale of the insurance and superannuation business to a larger fund manager. The investigation was a response to APRA's concern about the heavy exposure of the LifeTrack superannuation funds to traded life insurance policies. APRA intervened to prevent LifeTrack from further purchases of this nature. APRA considered that investment portfolios with a heavy concentration of relatively illiquid assets, like traded life insurance policies, can be inappropriate within the regulated superannuation system.

In March 2003, APRA revoked the approval of Host Plus Pty Ltd (Host Plus) as an Approved Trustee and suspended it as trustee of the HOST-PLUS Superannuation Fund for a period of 120 days. HOST-PLUS is a large industry fund in the hospitality and tourism industry. APRA's action followed a boardroom stalemate that had culminated in the resignation of the employer representative directors. Following a restructuring of the governance arrangements, APRA concluded that Host Plus had adequately addressed the issues that had led to APRA's action. In August 2003, APRA granted HOST-PLUS a licence as an Approved Trustee and re-instated it as trustee of the fund.

Also in March 2003, APRA accepted an enforceable undertaking from Strategic Capital Superannuation Services Pty Ltd (Strategic Capital), a Perth-based trustee of a multi employer-sponsor fund, effectively freezing the fund. APRA also commenced an investigation into the fund to establish whether members were at risk, given concerns about its governance and investments. In April 2003, APRA removed Strategic Capital and appointed an Acting Trustee, which carried out a number of tasks, including account reconstruction. The Acting Trustee is also considering whether any proceedings should be commenced. APRA's investigation has since identified a series of possible breaches by the former trustee including failure to keep adequate records, failure to undertake an audit by an approved auditor and failure to submit annual financial reports to APRA. There is evidence that the fund conducted its business as a retail superannuation fund and accepted contributions from the general public, even though the trustee was not approved for this purpose. APRA's investigation into the fund is continuing.

# 3 Supervisory issues in 2002/03



## AUTHORISED DEPOSIT-TAKING INSTITUTIONS

The year 2002/03 saw continued rapid growth in lending to the household sector, at an annual rate reaching around 20 per cent. The greater portion of this lending was for property and it spurred further strong rises in property prices. In this environment, APRA's supervision of authorised deposit-taking institutions (ADIs) focussed in particular on various aspects of property lending practices.

### Review of lending practices

During the year, APRA asked all ADIs to review the soundness of their lending practices. APRA acknowledged that residential property loans have historically been among the safest assets for Australian lenders, but noted that supervisory visits earlier in the year had identified a growing number of lending practices that were questionable in their prudence. APRA advised ADIs that if it finds unsound practices it will, where appropriate, lift minimum capital requirements to ensure that depositors are protected from the associated risks.

APRA has also cautioned ADIs against growing short-term profits at the expense of adequate investment in risk management capabilities. In its on-site visits, APRA is consulting with institutions on investment in management and controls across their entire risk spectrum and, in the case of conglomerate groups, is monitoring whether each conglomerate is maintaining good risk management practices across the group.

### Broker-originated lending

APRA has surveyed ADIs on the use of brokers to originate loans. Broker-originated loans are most prominent in the housing loan market, where they account for almost one-quarter of total loans outstanding and their usage is expected to grow. Broker-originated lending has the potential to provide significant cost advantages and growth opportunities for ADIs. At the same time, it may give rise to additional and potentially significant risks if ADIs do not subject broker-originated loans to the same credit standards as other loans or have prudent exposures to individual brokers.

APRA will be working with ADIs to ensure they develop and implement best practice risk management regarding the use of brokers.

### Stress-testing of property lending

APRA has been undertaking a "stress-testing" of ADI property lending to help it gauge the resilience of the ADI sector in the event of a substantial correction in the property market in Australia. The exercise requires ADIs to demonstrate that they have the appropriate capital strength, foreclosure and insurance claim processes and management plans to enable them to withstand a significant fall in property prices and handle increases in delinquent loans and mortgage defaults.

## GENERAL INSURANCE

The supervisory focus for the general insurance industry has been the bedding-down of the new prudential framework, which was introduced on 1 July 2002 through the *General Insurance Reform Act 2001* and associated prudential standards.

### General insurance reform

APRA has been overseeing the new prudential framework through continuous monitoring of information and statistics, consultations with management of supervised institutions and on-site reviews of insurers' operations and risk management systems.

As a result of the reforms, the general insurance industry in Australia is now subject to much higher prudential standards than prevailed previously. However, APRA has found in its supervisory visits that general insurers, both large and small, continue to face a range of risk management issues, particularly in dealing with risks across an institution as a whole. APRA has created a specialist insurance risk team of experienced industry practitioners to assist supervisors in identifying these issues and is working with insurers to address them.

### Risk management and reinsurance strategies

Two of the standards that are critical to strengthening the supervisory regime are those covering an insurer's Risk Management Strategy (RMS) and Reinsurance Management Strategy (REMS). The RMS aims to ensure that an insurer is well-managed, has access to appropriate independent expertise and has systems for identifying, managing and monitoring risks that may reduce the ability of the insurer to meet its obligations to policyholders. The REMS requires an insurer's board to set and document the insurance risk appetite for the institution, and to satisfy itself that appropriate controls and procedures are in place to ensure that this appetite is not exceeded and that the types of reinsurance arrangements implemented are appropriate.

APRA reviewed the RMS and REMS of each general insurer as part of the re-authorisation process and continues to review them as they are updated. APRA has also been developing detailed industry guidance in this area.

### Rising premiums

General insurance premiums continued to increase over 2002/03, particularly in long-tail classes of liability insurance such as public and product liability and professional indemnity.

In APRA's view, appropriate premiums for all classes of insurance are essential to the prudential soundness of the general insurance industry. The evidence would suggest, however, that in business lines such as professional indemnity insurance, premiums have been significantly underpriced in recent years. Structural reform in this area is likely to involve comprehensive tort law reform by the States, alternative dispute resolution arrangements that avoid litigation costs and, finally, self-regulation by professions to mitigate risk and reduce the incidence and severity of adverse outcomes. A Commonwealth/State working party has made significant progress in implementing coordinated tort law reform and professional standards legislation.

APRA has begun consultation with the insurance industry and other relevant bodies on the collection of policy and claims data for public liability and professional indemnity insurance. A Government initiative, the project aims to create a database which will assist the industry in determining appropriate premiums and developing suitable insurance products.

### Withdrawal of foreign insurers from Australia

In 2002/03, a number of foreign general insurance groups withdrew from Australia, either by selling or floating their Australian operations or by going into run-off. APRA has paid close attention to the consequences of these withdrawals for policyholders affected. Its main aim has been to ensure that the groups have maintained appropriate levels of capital in Australia after withdrawal and that risk management and transition issues are prudently handled.

### Direct offshore foreign insurers

APRA reinforced its alerts to consumers about the use of direct offshore foreign general insurance groups, which are not regulated by APRA. It urged policyholders, before taking out cover, to examine carefully the details of policies offered by these insurers, the long-term viability of the provider and potential difficulties in the event that a claim is made.

## LIFE INSURANCE AND FRIENDLY SOCIETIES

Over the first three quarters of 2002/03, the Australian share market fell by around 20 per cent from its recent peak, but it has since rallied. Falls in global share markets – and their subsequent recovery – tended to be more pronounced.

APRA's supervision of the life insurance industry during 2002/03 paid close attention to the impact of the weakness in equity markets on both fee revenues and investment values. Increases in premiums, defensive product changes and more active claims management are leading to improvements in insurers' experience in disability income insurance. With more than 85 per cent of the assets in statutory funds backing superannuation business, life insurers are also affected by issues facing other superannuation providers, such as unit pricing.

### Weaker equity markets

The weaker investment climate has had an impact on consumer sentiment, which has reflected in a deterioration in the level of sales in certain product lines. Retirement income inflows in the life insurance industry fell by 15 per cent over 2002/03. The ordinary (non-superannuation) investment and individual superannuation investment markets continued to suffer significant declines in in-flows. The associated declines in fee revenues have placed greater pressure on insurers to control expenses in these product lines to maintain profitability.

Accounting standards for life insurers are based on market values, so any write-downs in the value of investments reduce the capital available in statutory funds to meet obligations to policyholders, as well as reduce profit for shareholders. At the same time, the prospect of reduced future investment earnings increases the present value of insurers' liabilities for capital-guaranteed products. Life insurers operating in Australia must maintain resilience reserves to withstand economic adversity of this form. Since less than 40 per cent of their policyholder liabilities are capital-guaranteed, they have been able to do this better than their overseas counterparts, whose liabilities are more heavily weighted towards capital-guaranteed products.

Some insurers have substantial investments in distribution and financial planning businesses, which have fallen in value along with the declines in business volumes and fee revenue. Where such assets are held in statutory funds, any individual investments only count for capital purposes up to a limit of five per cent of the statutory fund; as a consequence, policyholders are not exposed to significant reductions in the value of such businesses.

## SUPERANNUATION

The weakness in equity markets and low interest rates has seen the superannuation industry suffer its first sustained period of poor investment returns. This has raised some prudential issues, including the funding position of defined benefit superannuation funds and the investment of superannuation monies in alternative assets. Looking ahead, the industry is facing significant changes with the Government's proposed reforms to superannuation. APRA has been preparing for these reforms, giving priority to developing plans for upgrading the risk management systems of superannuation funds.

### Defined benefit funds "health check"

During the year, APRA completed a "health check" of defined benefit superannuation funds, which showed that average solvency levels had declined across the industry following the downturn in equity markets. In general, the larger funds remained solvent and should have sufficient assets to meet members' benefit entitlements as they fall due. However, there were a number of funds experiencing funding shortfalls. Where there are funding shortfalls, APRA has been encouraging trustees and employers to restore funding to more appropriate levels and it has been liaising closely with professional bodies on this matter. The Government's proposed superannuation reforms provide for a strengthening of APRA's powers to gain timely information from auditors and actuaries about the funding position of defined benefit superannuation funds.

Recent funding problems may encourage more employers to wind-up their defined benefit funds and convert them to defined contribution (accumulation) funds. APRA is conscious of striking a balance between ensuring, as far as possible, that employers adequately fund members' benefits and not discouraging employers from offering higher than the minimum superannuation guarantee benefits.

### Alternative assets

The low returns in most superannuation funds have spurred interest by some trustees in investing superannuation monies in non-traditional assets, including hedge funds and instalment warrants.

During the year, APRA raised its concerns over the use of hedge funds as an investment choice. APRA recognised that there may be a place for hedge funds and other alternative investments within superannuation funds, but only where trustees have very carefully considered the risks to which they are exposing their members' funds. APRA provided trustees with guidance on the types of information they should be seeking from hedge fund managers and their asset consultants before committing superannuation monies in a hedge fund. APRA also undertook a survey of superannuation funds late in 2002/03 to assess the extent of hedge fund investments and found that trustees have, to date, taken a relatively cautious approach to these investments.

During the year, APRA and the Australian Taxation Office (ATO) urged trustees to exercise extreme caution in the purchase of instalment warrants following a proliferation of geared products being offered to superannuation funds. APRA and the ATO have determined that the use of shares owned by the fund as security over the in-built loan portion of an instalment warrant amounts to placing a charge over a fund's assets, which is prohibited under the *Superannuation Industry (Supervision) Act 1993.*

### Unit pricing

In February 2003, APRA released its findings on unit pricing practices and issues, following a number of targeted reviews across the industry. Issues observed included calculation errors; insufficient risk management processes; over-reliance on external fund managers; inadequate business continuity planning and inadequate valuation processes; and lack of senior management attention and adequate resources applied to unit pricing processes. Also of concern were legacy and multiple products and systems.

### Legacy products and systems

APRA has drawn attention to the need for financial institutions to address legacy issues as part of their normal planning cycle and has strongly advised, in particular life insurers and superannuation funds, to develop strategies to deal with superseded products and systems. Product legacy issues are largely confined to life insurance and superannuation, but obsolete systems are a common element of operational risk found across the financial services industry, generally as a result of mergers and acquisitions.

### Limited liability of service providers

APRA's policy on trustees accepting limitations to liability of service providers has been the subject of debate during the year. For investment managers, the superannuation legislation clearly prohibits any limitation on liability. For other superannuation service providers, APRA believes that trustees require guidance in negotiating contracts with a view to protecting members' interests. APRA is liaising with industry and other parties to explore a practical solution.

**APRA-regulated institutions**

| APRA-regulated institutions | Number 30/06/2002 | Number 20/06/2003 | % change from previous year | Assets ($ billion) 30/06/2002 | Assets ($ billion) 30/06/2003 | % change from previous year |
|---|---|---|---|---|---|---|
| ADIs[1] | 266 | 256 | -3.8 | 1 000.5 | 1 123.1 | 12.3 |
| Banks | 50 | 51 | 2.0 | 958.2 | 1 077.0 | 12.4 |
| Building societies | 15 | 14 | -6.7 | 12.5 | 13.0 | 4.0 |
| Credit unions | 196 | 187 | -4.6 | 25.7 | 28.6 | 11.3 |
| Other ADIs | 5 | 4 | -20.0 | 4.1 | 4.5 | 9.8 |
| Representative offices of foreign banks | 24 | 24 | 0.0 | N/A | N/A | N/A |
| General insurers | 146 | 143 | -2.1 | 67.5 | 73.6[2] | 9.0 |
| Life insurers | 42 | 40 | -4.8 | 183.3 | 181.3[3] | -1.1 |
| Friendly societies | 36 | 35 | -2.8 | 6.1 | 6.1 | 0.0 |
| Approved Trustees | 160 | 158 | -1.3 | N/A | N/A | N/A |
| Superannuation entities | 11 402 | 10 610 | -6.9 | 330.8 | 328.1[4] | -0.8 |
| Public offer funds | 373 | 323 | -13.4 | 181.1 | 202.3 | 11.8 |
| Non-public offer funds | 2 389 | 1 830 | -23.4 | 142.6 | 118.3 | -17.0 |
| Small APRA Funds (SAFs) | 8 127 | 7 990 | -1.7 | 2.6 | 2.6 | 0.0 |
| Approved deposit funds | 324 | 293 | -9.6 | 1.5 | 1.2 | -20.0 |
| Eligible rollover funds | 10 | 14 | 40.0 | 3.0 | 3.7 | 23.3 |
| Pooled superannuation trusts | 179 | 160 | -10.6 | N/A | 40.6[5] | N/A |
| Total | 12 076 | 11 266 | -6.7 | 1 588 | 1 712 | 7.8 |

1 The ADI classification does not include representative offices of foreign banks.
2 Some variation in assets is due to general insurers now reporting under a new prudential framework.
3 Total life office statutory fund assets backing Australian policyholder liabilities.
4 Assets for superannuation entities reflect assets on the latest annual return received.
5 PST Assets not included in totals as funds are already recorded in other superannuation categories.

# 4 The prudential supervision framework

The evolution of the prudential supervision framework over 2002/03 was strongly influenced by several developments in the broader financial services environment. These included the Royal Commission into the collapse of HIH; the Government's reforms of medical indemnity insurance; preparations for licensing of superannuation funds; progress in the new Basel Capital Accord; and reform of the credit card industry.

## General insurance reform

The new prudential framework for general insurers has substantially strengthened and modernised the prudential requirements applying to general insurers in Australia.

In its submission to the HIH Royal Commission, 'Policy Directions for the Regulation and Prudential Supervision of General Insurance (September 2002)', APRA offered its views on how the prudential framework could be further strengthened. This includes the extension of prudential requirements to cover consolidated groups, improved disclosure and enhanced corporate governance.

The Royal Commissioner's recommendations on the prudential framework for general insurance were consistent with APRA's submission and the views of the Palmer Report. The Government has recently announced its response to these recommendations and a second round of general insurance reform will now get under way. In this context, APRA is planning to release a discussion paper, 'Prudential Supervision of General Insurance – Stage 2 Reforms' for public consultation in the latter part of 2003.

## Medical indemnity insurance reform

*The Medical Indemnity (Prudential Supervision and Product Standards) Act 2003* (MI Act) commenced on 1 July 2003 and prohibits institutions from providing medical indemnity cover unless the institution is an authorised general insurer under the *Insurance Act 1973*.

The regulatory measures imposed by the MI Act provide doctors and their patients with more certainty than under previous discretionary arrangements that claims against a medical practitioner for professional negligence or misconduct will be met.

Under the MI Act, certain institutions providing medical indemnity cover will have up to five years to comply with the minimum capital requirements imposed by prudential standards made under the *Insurance Act 1973*. To facilitate this transition, APRA has issued guidelines under the MI Act on:

- matters to be included in a funding plan;
- certifications by auditors and actuaries; and
- qualifications and independence of auditors and actuaries.

APRA worked extensively with industry and interested parties in developing these guidelines to ensure that its expectations in relation to transitional capital arrangements were clear.

Under Section 24 of the MI Act, APRA is also developing guidelines regarding reasonable premiums for certain types of medical indemnity cover. APRA commenced discussions with interested parties in August 2003 and expects the guidelines to come into effect for the 2004 policy renewal period, following a period of public consultation.

### Superannuation licensing

In October 2002, in response to the Superannuation Working Group Report into the safety of superannuation, the Government proposed a number of significant reforms to the industry. These reforms will be given effect through amendments to the S*uperannuation Industry (Supervision) Act 1993* to be introduced into Parliament shortly.

Central to the reforms is a new superannuation licensing regime involving compulsory licensing for trustees of all APRA-regulated superannuation entities, registration of those entities and risk management requirements for trustees and entities. There will be different classes of trustee licences and trustees will be able to choose the class of licence most applicable to their business. The requirements applying to licences will vary according to the nature and complexity of a superannuation fund's business. Trustees will also have to comply with operating standards covering such matters as risk management and fitness and propriety. These standards will provide legislative support for increased trustee skills and diligence, and appropriate levels of professionalism in the industry. APRA provided extensive input into the development of the reform proposals and will be closely involved in the drafting of the operating standards.

The Government expects these reforms to commence in April 2004, with a two-year licensing period to commence in July 2004. On the latest numbers, the program will entail APRA licensing around 2,200 trustees, including the 157 public offer trustees currently approved, as well as registration of over 10,000 funds.

### Basel Capital Accord

Global reform of capital adequacy requirements for deposit-taking institutions, under the aegis of the Basel Committee on Banking Supervision (the Basel Committee), has continued to move forward and APRA has been actively involved in this process. In April 2003, the Basel Committee released its third consultation document on the New Basel Capital Accord (also known as Basel II). This followed the completion in October 2002 of a third quantitative impact study, which was aimed at ensuring the effectiveness of the Basel II proposals and assisting in gathering information to assess possible modifications.

The new Accord will have three key elements:

- new and considerably more sophisticated minimum capital requirements (Pillar 1);
- institutions' own assessment of their capital adequacy and enhanced supervision of capital management processes (Pillar 2); and
- materially-increased disclosure requirements (Pillar 3).

APRA welcomes the proposals for more risk-sensitive capital requirements in the new Accord. The range of approaches that will be available to banks and other ADIs for credit and other key risks is a deliberate move by supervisors away from a "one-size-fits-all" approach. In APRA's view, there is no generically "right" approach across the deposit-taking sector and the most appropriate solution for each institution will depend on its individual circumstances.

In June 2003, APRA wrote to ADIs providing a broad outline of how it intended to implement the new Accord. In particular:

- APRA expects the four major banks to seek to implement one of the more sophisticated (internal ratings-based) approaches for credit risk. Other ADIs are expected initially to adopt the standardised approach for such risk but may apply to adopt the internal ratings-based approaches if they can meet the appropriate requirements;
- APRA will require banks adopting the internal ratings-based approaches to adopt the more sophisticated approach for operational risk, and intends to require such banks to meet a mandatory capital requirement for interest rate risk in the banking book; and
- other ADIs will be expected to adopt one of the simpler approaches to operational risk, while any requirement to hold regulatory capital against interest rate risk will be determined on a case-by-case basis.

APRA expects that banks using the more sophisticated approaches may have some reduction in regulatory capital from the levels required under the simpler approaches. The size of any reduction, however, is yet to be quantified. It also expects that ADIs using the simpler approaches will, on average, experience a modest reduction in regulatory capital.

As the new Accord is finalised, APRA will continue to liaise with industry to monitor the progress of ADIs and ensure the fair and consistent implementation of Basel II in Australia. APRA has commenced on-site review visits to ADIs proposing to adopt the more sophisticated approaches to capital measurement. Feedback from these visits, and also from the third consultation document, will influence the integration of the new Accord into prudential standards in Australia and assist in formulating benchmarks for use in the final accreditation process for Australian ADIs.

Draft prudential standards for Australian ADIs are expected to be released for public consultation by mid-2004. APRA plans to implement the new Accord in Australia at the beginning of 2007. Institutions will run parallel regimes through 2006 to facilitate the transition.

### Prudential standards for conglomerates

In November 2002, APRA released updated prudential standards for ADIs governing large exposures and associations with related entities. Effective from 1 July 2003, these standards tighten the rules on ADI exposures to third parties and to related entities within a conglomerate group, by stipulating a comprehensive system of exposure limits that reflect different counterparty risks. The standards also give APRA the power to impose capital requirements on an ADI where APRA is not satisfied that the group-wide approach to risk measurement and capital allocation is adequate.

APRA also finalised revised requirements for ADIs to deduct investments in subsidiaries and other entities from capital to avoid double counting for regulatory purposes. The new deduction rules will be implemented to coincide with the introduction of the new Accord at the beginning of 2007.

### Proposed guidelines on capitalised expenses

In September 2002, APRA surveyed ADIs on the accounting treatment for recognising capitalised expenses and intangible assets for financial and regulatory reporting purposes. The results highlighted that exposure to capitalised expenses at the industry level was modest but that, for several ADIs, it comprised a material proportion of their regulatory capital base. In addition, the financial reporting and capital adequacy treatment of certain capitalised expenses was not consistent across the industry.

In June 2003, APRA issued proposed guidelines to ADIs on the inclusion of certain types of capitalised expenses as intangible assets for prudential purposes and their deduction from Tier 1 capital. These include loan origination fees and commissions paid to originators and brokers, securitisation establishment costs and costs associated with debt/capital raisings. This proposal standardises the capital adequacy treatment across the industry, irrespective of the accounting policy adopted by individual ADIs and is consistent with the prudential accounting treatment for similar assets recognised by APRA-regulated general insurers.

The proposal has been open to a period of public consultation, which closed on 30 September 2003. Subject to the results of the consultation process, APRA envisages that new requirements in relation to capitalised expenses will come into force in July 2004.

### Credit card reform

In 2002/3, APRA introduced a new category of ADI known as Specialist Credit Card Institutions (SCCI), in the context of reforms of the Australian credit card market undertaken by the Reserve Bank of Australia (RBA). These new institutions will be supervised by APRA under the *Banking Act 1959* and will be authorised to engage only in credit card operations.

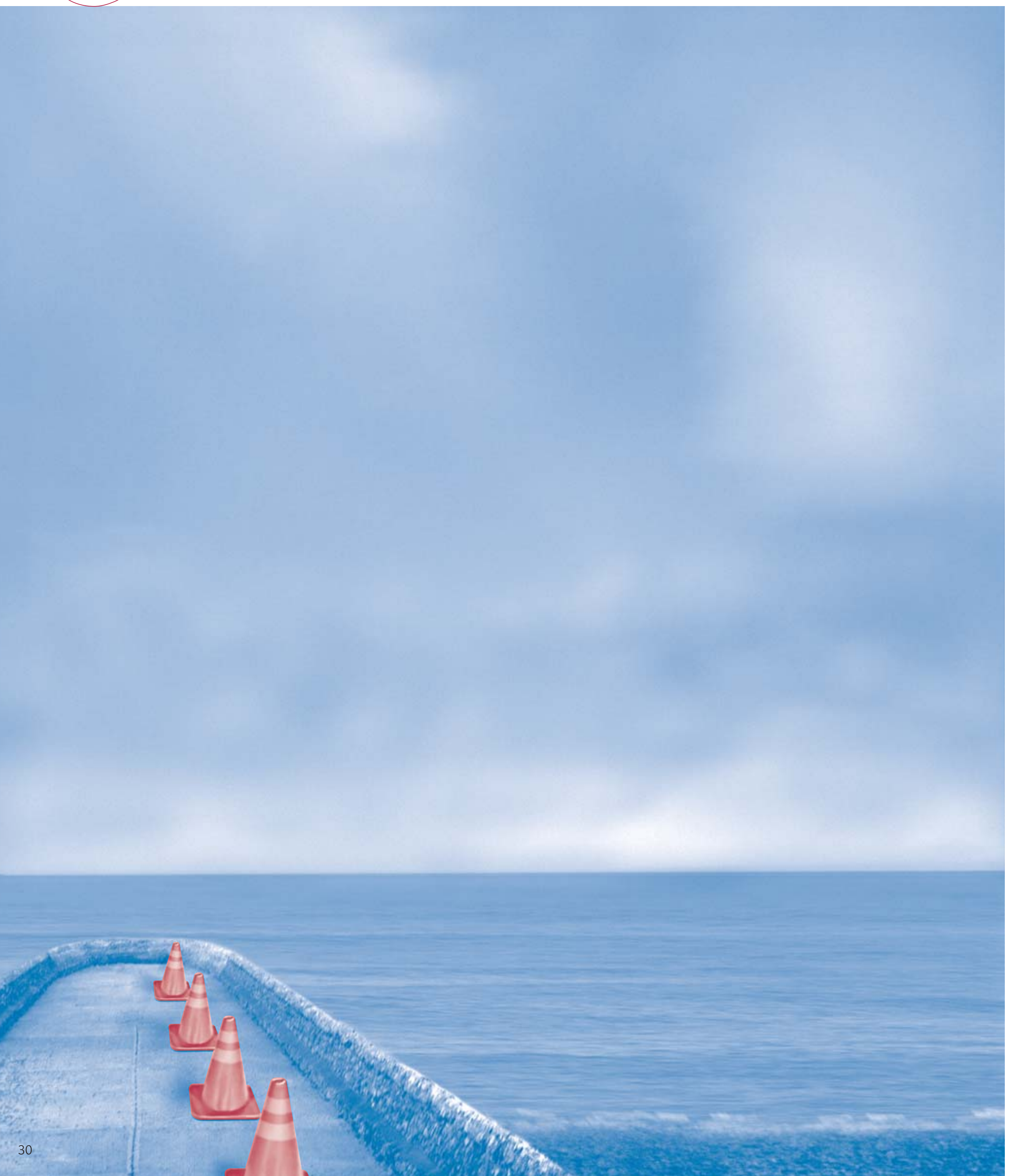
The change is designed to increase competition in the Australian credit card market by facilitating entrance to credit card schemes. SCCIs will be subject to the same authorisation, prudential and reporting requirements applicable to traditional ADIs, but will be required to maintain a higher minimum capital ratio because their risk is concentrated in one business line.

### Financial statistics

Financial statistics are at the centre of APRA's supervisory strategy and over recent years the statistical framework and infrastructure that underpin risk judgments by supervisors have undergone continued development. The focus has been on the relevance and reliability of information and the efficiency with which it is collected.

General insurers, superannuation entities and registered financial corporations (which are not supervised by APRA) now use the D2A (Direct to APRA) software to provide statistical information to APRA. They join authorised deposit-taking institutions which have now been using D2A for more than a year. The D2A software allows reporting entities to compile their statistical returns and lodge them electronically and securely with APRA. The system itself is a single component of a new, integrated data management platform called @APRA, which facilitates the collection, processing, validation, management and dissemination of data on the finance sector. APRA acts as the central repository of financial information for the Australian Bureau of Statistics and the RBA, so that reporting entities need only supply information to one point for distribution to these agencies. To reduce the burden on industry further, the three agencies have sought to harmonise their data requirements wherever possible.

# 5 APRA's costs and performance



APRA's expenditure is devoted, directly or indirectly, to prudential supervision, regulation and enforcement activities in relation to supervised financial institutions. Its income comes mostly from annual levies on these entities. APRA's financial performance can be judged in the traditional way against budget targets, but a wider range of quantitative and qualitative measures have been developed by APRA to assess its overall performance as a prudential supervisor.

## FINANCIAL PERFORMANCE

### APRA's expenditure

APRA's total operating expenditure from ordinary activities in 2002/03 was $68.6 million. This included costs of $4.3 million in relation to the HIH Royal Commission and costs of $1.6 million, which are covered by additional revenue sources. Excluding these amounts, net operating expenditure was $62.7 million, compared with the original budget of $60.7 million. The HIH Royal Commission costs are fully offset by recoveries from insurance and an additional appropriation from the Commonwealth that are included within revenue.[1]

The table below shows the trend in net operating expenditure on prudential regulation, and staff in Australia engaged, directly or indirectly, in this over recent years. The numbers have been adjusted for comparison.

The integration of eleven separate supervisory agencies into a single regulator was completed over the first two years of APRA's life, following its establishment on 1 July 1998. From 2001/02 onwards, the running costs of prudential supervision have risen as a consequence of more intensive supervision activities and an active program to upgrade the prudential framework. This trend will continue in 2003/04. In addition, specific funding has been provided by the Government to carry out the recommendations of the HIH Royal Commission.

| | $ million[2] | Average staffing level |
|---|---|---|
| 1997/98 (estimate) | 56.5 | 559[3] |
| 1998/99 (estimate) | 59.9 | 482[3] |
| 1999/00 | 52.8 | 397[3] |
| 2000/01 | 52.5 | 396[3] |
| 2001/02 | 55.8 | 407 |
| 2002/03 | 62.7 | 457 |
| 2003/04 (budgeted) | 69.2 | 517 |

1 The original appropriation sought for the HIH Royal Commission was $4 million, when the position and extent of coverage regarding insurance was unclear. Subsequently, a high proportion of costs is being recovered through insurance.

2 The figures are operational expenditures that have been normalised for comparison and exclude establishment costs. The 1997/98 figures are estimates for the aggregate costs of predecessor organisations including the State-based regulators. The figures have been adjusted to exclude the Australian Government Actuary, activities transferred to the Australian Taxation Office and the consumer protection functions within former agencies. The figures have also been adjusted for the netting of costs with associated revenues.

3 2000/01 and earlier years Full Time Equivalent staff as at 30 June.

### 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 2002/03 is an insurance recovery of $3.3 million for costs incurred in representing APRA before the HIH Royal Commission. In addition, an appropriation of $1.5 million from the Government has been provided to assist with costs that are not covered by insurance.

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 Treasurer announces the levy determinations 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 the Australian Securities and Investments Commission and the Australian Taxation Office. The process includes detailed consultation with the main industry groups and with Treasury. Levies are based on industry sectors. The total levies collected by APRA for all three agencies in 2002/03 were $74.6 million, compared with the plan of $74.3 million.

APRA's total revenue from ordinary activities in 2002/03 was $68.4 million. After adjusting for HIH Royal Commission funding and additional revenues to cover specific costs, net revenue was $62.6 million, compared with the original budget of $62.2 million.

### Reserves

APRA incurred a small deficit of $0.2 million in 2002/03, which resulted in a reduction in accumulated surpluses to $3.3 million. This was equivalent to 5.5 per cent of net levies appropriated to APRA, at the lower end of the target range of five to ten per cent that had been set by APRA's Board.

## BUSINESS PLANNING AND PERFORMANCE

APRA has continued to develop the business planning, measurement and reporting framework that was introduced the previous year. This aims to integrate APRA's mission, vision, values and approach with measurable outcomes and outputs, which go beyond APRA's financial 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 financial safety, efficiency, competition, contestability and competitive neutrality. Key strategies have been identified that will achieve this business outcome in a cost-effective manner.

The business plan is organised into six Key Result Areas (KRAs). They are:

- supervision, enforcement and rehabilitation;
- policies, standards and guidelines for prudential supervision;
- prudential advice, covering relations with Government, Parliament and other interested parties;
- resources;
- infrastructure to support operations; and
- accountability.

The accompanying box outlines KRAs according to prime objective, strategies, actions and prime Key Performance Indicators (KPIs).

Three of the KRAs align with the APRA outputs of surveillance, policy development and prudential advice, which are described in the budget papers. The remaining three KRAs – resources, infrastructure and accountability – align with administrative support and corporate governance. The estimated percentage distribution of APRA's operating expenditure across its main activities in 2002/03 is shown below. The allocation to outputs is shown in Note 23 to the Financial Statements.

- supervision, rehabilitation and enforcement — 55 per cent
- development of prudential policies and standards — 8 per cent
- prudential advice — 9 per cent
- administrative support and corporate governance — 28 per cent

Last year, APRA's business plan introduced two new KPIs – the Performing Entity Ratio (PER) and the Money Protection Ratio (MPR). The PER is the number of APRA-regulated entities meeting their commitments to beneficiaries, divided by the total number of APRA-regulated entities. The MPR is the dollar value of accounts protected by APRA in regulated entities meeting their commitments to beneficiaries, divided by the total dollar value of accounts protected by APRA in all regulated institutions. These measures are a general quantitative indicator of APRA's supervisory performance.

Since APRA's inception in 1998, the PER has averaged 99.95 per cent and the MPR 99.89 per cent. Annual movements are shown below. Both ratios account for the HIH Group's estimated $5.3 billion loss incurred by creditors and policyholders[1].

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

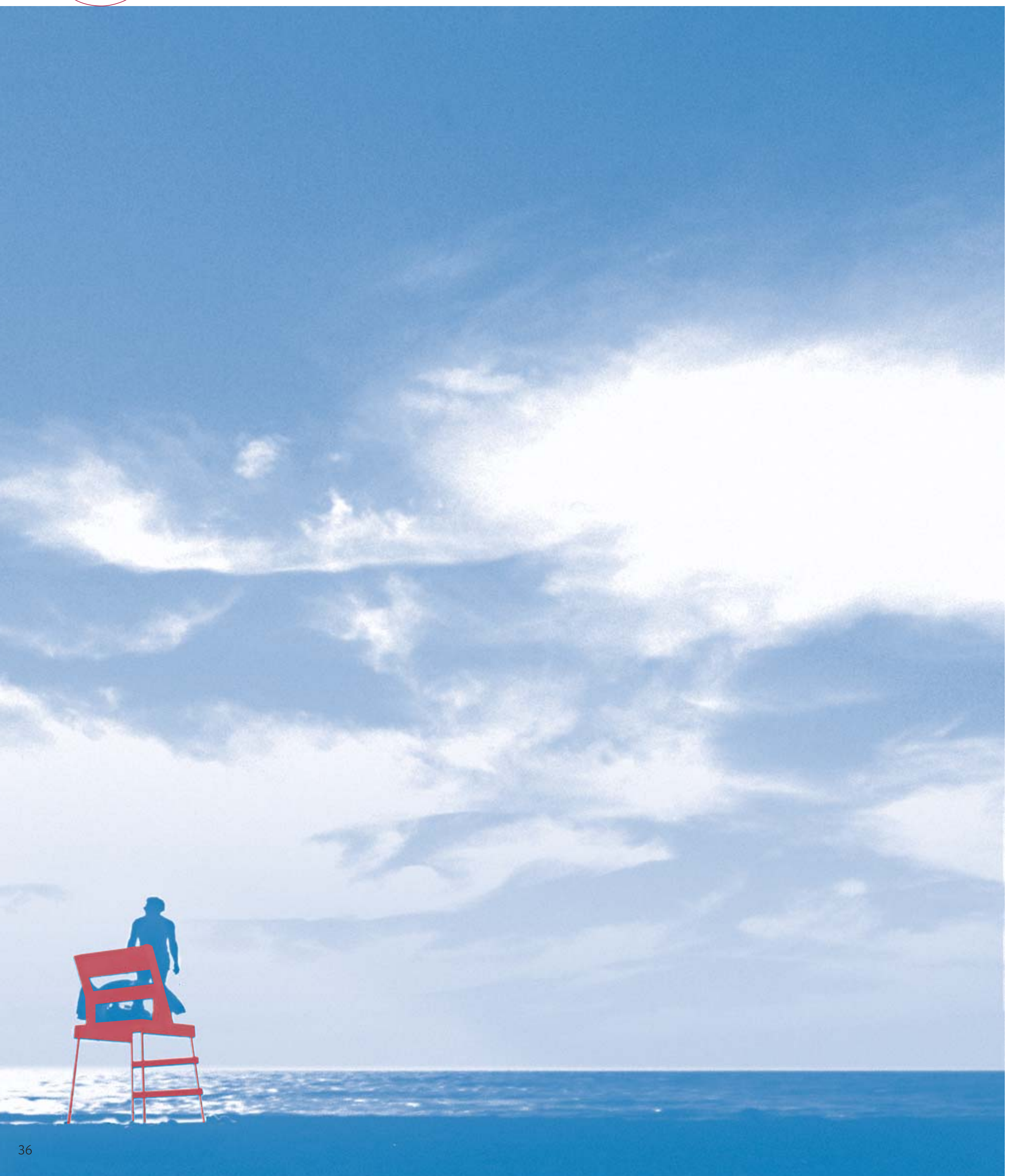
| Financial Year | Number of failures[2] | Losses ($ million) | Number of institutions[3] | Protected accounts[4] ($ million) | Annual PER % | Annual MPR % |
|---|---|---|---|---|---|---|
| 1999 | 2 | 10 | 4,475 | 874,162 | 99.96 | 99.99 |
| 2000 | 3 | 308 | 4,455 | 982,484 | 99.93 | 99.97 |
| 2001 | 3 | 5,332 | 4,252 | 1,046,580 | 99.93 | 99.49 |
| 2002 | 0 | 0 | 3,940 | 992,820 | 100.00 | 100.00 |
| 2003 | 2 | 1 | 3,380 | 1,046,030 | 99.94 | 99.99 |

1 Based on liquidator's advice to creditors in April 2002.
2 Failures exclude unresolved cases and failures due to employer sponsors in superannuation funds.
3 The number of institutions excludes Small APRA Funds and representative offices of foreign banks.
4 Protected accounts is an estimate of the funds protected by APRA as defined by relevant legislation and is less than total assets held by APRA-regulated institutions, which were $1,712 billion at end - June 2003.

| KRAs | Supervision | Policy | Prudential advice |
|---|---|---|---|
| Prime objective | Minimise financial loss to depositors, policyholders and superannuation fund members through appropriate intervention | Develop prudential policies, standards and guidelines for minimising losses to depositors, policyholders and superannuation fund members | Maintain open communication and constructive relationships with all interested parties |
| Strategies | • Supervise based on risk-rating<br>• Respond to economic and industry trends<br>• Vigorously apply enforcement<br>• Improve management of workflow and processes<br>• Closely monitor performance<br>• Implement strong project management framework | • Develop policies on conglomerates and develop consistent, risk-based supervisory approaches across supervised industries<br>• Contribute to international policy development<br>• Develop appropriate response to supervision issues, industry and macro-economic trends | • Government and Treasury fully-informed on supervisory developments, reforms and emerging issues<br>• Open communications to all interested parties<br>• Prompt response to public inquiries |
| Actions | • Implement enhanced risk-rating system<br>• Prompt response to economic and industry intelligence<br>• Early identification of enforcement triggers<br>• Upgrade workflow and processes<br>• Drive consistency of practice across divisions | • Implement the work program for: response to recommendations of HIH Royal Commission, superannuation, Basel 2 Capital Accord, conglomerates and powers for enforcement and managing institutional failure<br>• Maintain active membership of key regulatory and industry forums<br>• Maintain close coordination with RBA and ASIC | • Liaise with Ministers and Treasury on proposed legislative changes<br>• Implement pro-active communication plans on issues of public interest<br>• Maintain effective and timely liaison with industry, professional and consumer groups<br>• Maintain best practice in the APRA Contact Centre including management of Return of Benefits |
| Prime KPIs | • Number of institutional visits<br>• PER<br>• MPR<br>• Number of institutions entering and leaving enforcement<br>• Supervision ratio | • Risk by institutional ranking<br>• Statistical profile of institutions by number and value<br>• Policy development to plan<br>• Policy development time to total time | • Expenditure on communication programs/plans<br>• Number of meetings with Minister and Treasury<br>• Number of meetings with industry, professional and consumer groups<br>• APRA Contact Centre response times |

| KRAs | Staff | Infrastructure | Accountability |
|---|---|---|---|
| Prime objective | Sufficient staff with skills, experience and knowledge that meet prime objectives and strategy | Cost-effective infrastructure that fully supports prime objectives with professional support services | Assurance that objectives are met and risks are managed |
| Strategies | • Committed to excellence<br>• APRA as employer of choice<br>• Outstanding managerial and technical expertise | • Integrated depository of statistical data supporting the rapid distribution of financial information to key users<br>• Expand on management and accumulation of knowledge<br>• Best practice financial and information technology systems and processes | • Meet statutory and government obligations<br>• Meet international standards<br>• Improved performance through planning and measurement<br>• Internal risks assessed and managed<br>• Fully-funded to meet objectives |
| Actions | • Update HR programs (performance and skills development)<br>• Innovative recruitment strategies, career planning, skills development based on capability framework | • Complete Statistics Project, integrate and improve delivery of industry statistics<br>• Implement electronic document management system<br>• Review sources of funding including levies and fees for service<br>• Monitor delivery of service level agreements<br>• Improve business continuity plan | • Senior management to attest to corporate governance<br>• Implement the Basel and IAIS core principles and IMF framework<br>• Broaden quality assurance agenda<br>• Review the adequacy of funding<br>• Integrate planning, measurement and reporting of performance<br>• Implement risk and audit programs |
| Prime KPIs | • Number of staff to plan<br>• Staff turnover ratio<br>• Training per employee<br>• Prudential supervision experience<br>• Activity by function and industry | • Industry returns on time<br>• Levies collected to plan<br>• Operating and capital expenditure to budget<br>• Cash flow to plan<br>• Occupancy per employee<br>• IT performance to targets | • Number of control risks rated as high<br>• Number of audit issues open<br>• Accumulated reserves/levies<br>• Number of internal audit reviews<br>• Number of risk assessments<br>• Number of Risk Management and Audit Committee meetings |

# 6 Cooperation and liaison



Since its establishment, APRA has recognised the importance of developing strong relations with other regulatory agencies at both a national and international level and encouraging regular liaison with relevant industry bodies. The HIH Royal Commission offered recommendations on how these cooperative efforts should be taken forward.

## Australia

APRA is one of three independent statutory agencies, which together comprise the framework that regulates Australia's financial sector. The other two agencies are the Reserve Bank of Australia (RBA) – which is responsible for monetary policy, systemic stability and payments system regulation – and the Australian Securities and Investments Commission (ASIC) – whose role is primarily concerned with disclosure and conduct of Australian companies and financial services providers, and is responsible for the administration of the Corporations Law as well as consumer protection in the financial system.

High-level cooperation between these three agencies takes place under the aegis of the Council of Financial Regulators. The Council has no regulatory functions of its own, but operates as a forum for sharing information and views and discussing regulatory issues. Following the recent change in APRA's governance arrangements, which ended the formal links between the three agencies at APRA Board level, the Council is expected to play an enhanced role and its membership is being broadened to include the Treasury.

APRA also has close bilateral arrangements with the RBA and ASIC, under memoranda of understanding (MOUs) it has entered into with each of these agencies. Regular dealings with the RBA are conducted through the RBA/APRA Coordination Committee; in 2002/03, major items for discussion included the rapid rise in property lending, crisis management arrangements and the sharing of statistics collected by APRA.

APRA and ASIC have devoted considerable effort to improving inter-agency cooperative arrangements. During 2002/03, the two agencies worked together on a number of occasions, successfully resolving difficulties facing several regulated entities in close cooperation. Given the differing remits of the two organisations, a key issue has been achieving a balance between APRA's need to work confidentially with an entity in resolving risk issues and the need under Corporations Law for continuous disclosure.

APRA and ASIC have updated their information-sharing agreements with each other and have improved day-to-day communication. During the upcoming year, the two regulators will continue to cooperate on individual supervisory matters, on the various tasks flowing from the Report of the HIH Royal Commission and on ensuring that APRA-regulated entities meet ASIC standards with respect to Australian Financial Services Licence applications.

APRA works closely with the Treasury in the development of the financial regulation framework and on associated legislative changes. APRA and the Australian Taxation Office have continued to consult on the detail of interpretative and guidance material issued jointly or separately in relation to areas of legislation administered by both agencies.

APRA also has regular high-level liaison meetings with industry bodies such as the Australian Bankers' Association, the International Banks and Securities Association, the Investment and Financial Services Association, the Association of Superannuation Funds of Australia, the Insurance Council of Australia, the Institute of Actuaries of Australia and the professional accounting bodies to discuss issues of current interest or concern.

## International liaison

APRA is a member of several significant international bodies concerned with its areas of operation, and participates actively in their functions. It is also increasing its liaison with overseas regulators to improve its knowledge of the offshore operations of Australian institutions and of the home-country operations of overseas institutions represented in Australia.

In this context, the Report of the HIH Royal Commission recommended that APRA take steps to ensure there is an effective exchange of information with overseas regulators on Australian insurers with international operations. In line with this recommendation, APRA has been looking at ways of improving the exchange of confidential prudential information. It has entered into negotiations on MOUs with regulators in other jurisdictions including the United Kingdom, Germany and Singapore. APRA also signed a MOU with the Reserve Bank of New Zealand in mid-2003.

The various international groups and forums in which APRA has been active in 2002/03 include:

- International Association of Insurance Supervisors (IAIS) – An APRA executive was deputy chair of the IAIS Executive Committee in 2002 and has since been appointed chair of the IAIS Technical Committee. APRA is represented on the IAIS sub-committees for Accounting (work agenda includes revisions to international standards), Solvency (stress testing, appropriate forms of capital and convergence of solvency standards) and Investments (credit risk transfer and investment risk management). APRA also participated in the IAIS Task Force on Revisions to the Insurance Core Principles and Methodology, which has distributed the final draft revision for comment. APRA seconded an officer to the IAIS Secretariat for the 18 months to October 2002 to provide training and support.
- Basel Committee on Banking Supervision – APRA is not a member of this Committee but is represented on and provides input to a number of groups established under its auspices. These include the Core Principles Liaison Group (CPLG), which is the main vehicle for consultation between the Basel Committee and non-member countries and provides a forum for discussion of prudential issues. During 2002/03, topics discussed by the CPLG included loan classification and provisioning, the impact of proposed new international accounting standards, supervision of foreign currency positions and the need to balance supervisory independence and accountability.

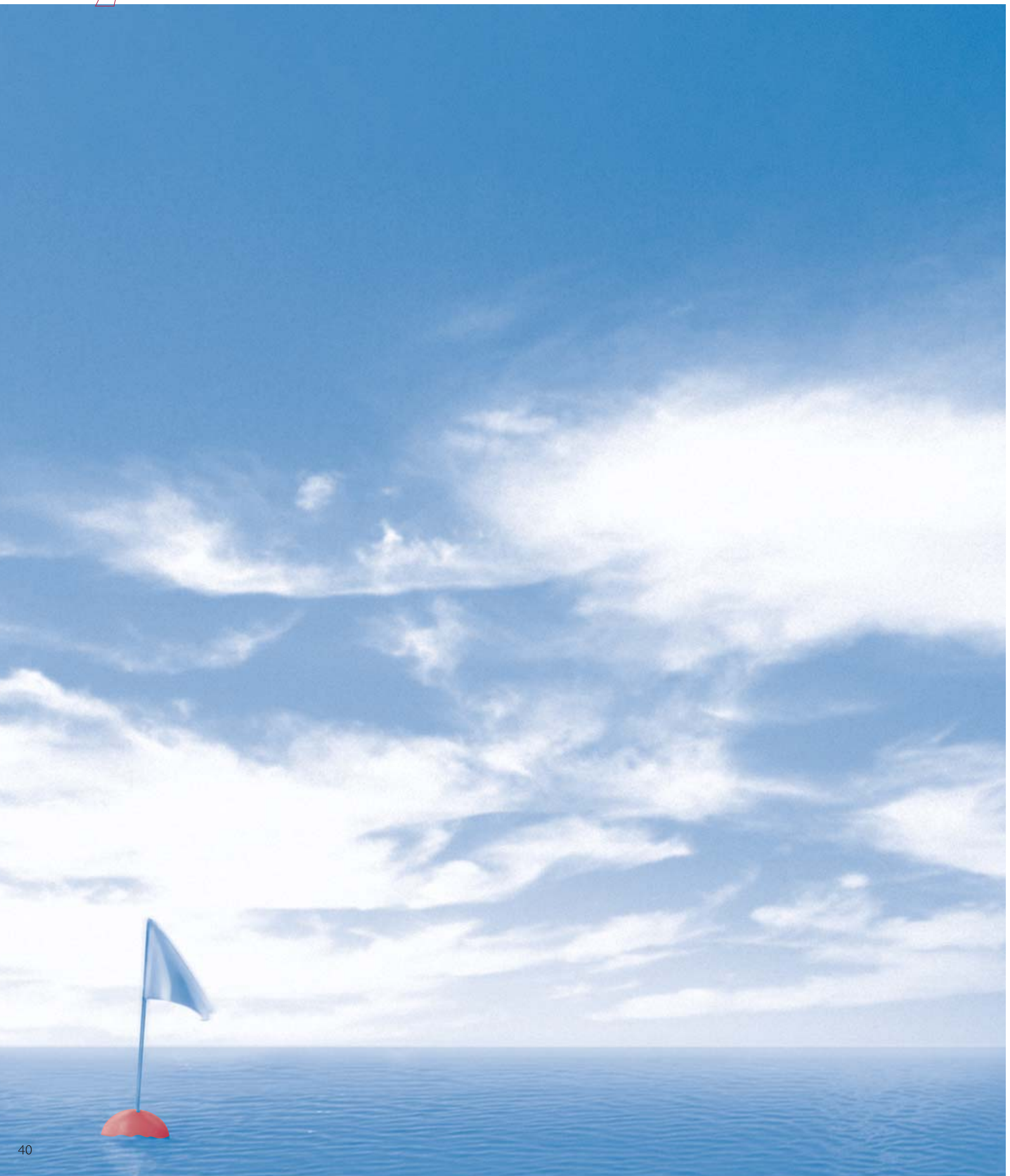
  APRA has been a major contributor to the work of the CPLG Capital Working Group, which provides advice and guidance on the development of the new Basel Capital Accord. In 2002/03, APRA seconded staff members to the Basel Committee Secretariat and participated in the third Quantitative Impact Study (QIS3), leading the analysis and coordination of responses for forty-three countries outside the G-10 and the European Union.

  APRA is also represented on the Basel Committee Electronic Banking Group, which has been focussing mainly on cross-border electronic banking issues.
- Joint Forum – APRA is a member of the Joint Forum, which brings together the IAIS, the Basel Committee and the International Organisation of Securities Commissions (IOSCO) to discuss cross-sectoral issues. During 2002/03, the Joint Forum has been reviewing the methods used in determining economic capital across global conglomerates and the disclosures made by banking groups.
- OECD Insurance Committee – APRA is represented on this Committee and on the related Working Group on Private Pensions. During the year, APRA participated in the Committee's work on terrorism insurance, environmental risk and governance structures in insurance firms. The Group looked at superannuation supervision guidelines and prepared a template for assessment of pension systems for the IMF/World Bank's Financial Sector Assessment Programs.
- International Network of Pensions Regulators and Supervisors (INPRS) – APRA supports this OECD-sponsored body and is a member of its technical committee and Asia/Pacific Regional Group.
- International Actuarial Association (IAA) – APRA's actuarial staff participate in committees of the IAA.

During 2002/03, APRA also supported a range of regional initiatives to promote the development of supervisory infrastructure and skills, the sharing of information and the maintenance and promotion of standards in financial services regulation. This includes participation by APRA staff, either as presenters of papers or as delegates, in various regional conferences and workshops. 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), a grouping of regional central banks and monetary authorities. The Working Group provides a forum to discuss financial developments in the region as well as progress on the new Basel Capital Accord. APRA hosted a regional workshop on Market Risk in Sydney in April 2003 and extended its involvement in the Financial Regulators Training Initiative, a joint initiative of APEC, AusAID and the Asian Development Bank for life insurance and pensions regulators.

In addition, APRA hosted more than 30 international delegations from multilateral organisations, the OECD and regional regulatory and other agencies. APRA also accepted staff from several overseas regulatory agencies on secondment.

# 7 Corporate governance



A new governance structure for APRA came into effect on 1 July 2003, through amendments to the *Australian Prudential Regulation Authority Act 1998* (APRA Act).

## Original governance structure

The governance structure in place during the 2002/03 reporting period, and from the time of APRA's establishment, involved an executive Board, including ex officio members, and a Chief Executive Officer. The APRA Board was accountable for APRA and the responsibilities of APRA Board members were found in legislation and common law. The relevant statutes included the APRA Act and the *Commonwealth Authorities and Companies Act 1997*.

APRA's purpose, as set out in section 8 of the APRA Act, was to regulate bodies in the Australian financial sector in accordance with applicable laws and to develop the policy to be applied in performing that regulatory role. In doing this, APRA was to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

The Board's functions, as set out in section 17 of the APRA Act, were to:

- determine APRA's policies (including goals, priorities, strategies and administrative policies);
- ensure that APRA performs its functions properly, efficiently and effectively; and
- ensure that APRA's operations are conducted having regard to its purpose as stated in section 8.

In addition, other sections of the APRA Act referred to the obligations of the Board to inform the Government of APRA's policies (section 12) and to hold meetings.

The APRA Board comprised up to nine members of whom six, including the Chair and the Chief Executive Officer, were appointed by the Treasurer for terms of up to five years. Two ex officio members were appointed by the Governor of the Reserve Bank of Australia and one by the Chairman of the Australian Securities and Investments Commission.

Under the APRA Act, the Board delegated some of its functions to the Chief Executive Officer, a Board Member or members of staff.

During 2002/03, APRA Board members were:

**Dr Jeffrey Carmichael AO**
Chair (non-executive)
BCom (Hons 1), MCom (Hons) (UNSW), MA, PhD (Princeton), AIBF, AIFS

Member of Financial System Inquiry, previously Chair of the Australian Financial Institutions Commission and the Queensland Office of Financial Supervision and financial consultant and company director.

**Mr Graeme Thompson**
Chief Executive Officer (executive)
BEc (Hons) (Syd)

Former Deputy Governor of the Reserve Bank of Australia with responsibilities for banking supervision and surveillance of the payments system. APRA representative on RBA's Payments System Board and on the Council of Financial Regulators.

**Mr Rod Atfield**
(non-executive)
FIA (UK), FIAA

Previously Managing Director of the Mercantile Mutual Group, with extensive experience in the insurance field.

Professor Berna Collier
(non-executive, ex officio)
BA, LLB (Hons) (Qld), LLM (Melb)

Commissioner of the Australian Securities and Investments Commission.

Dr David Knox
(non-executive)
BA, PhD (Macquarie), FIA (UK), FIAA

Director of PricewaterhouseCoopers Actuarial and previously Foundation Professor of Actuarial Studies at the University of Melbourne.

Dr John Laker
(non-executive, ex officio)
BEc (Hons 1) (Syd), MSc PhD (London)

Assistant Governor (Financial System) of the Reserve Bank of Australia, Deputy Chairman of the Payments System Board and a Reserve Bank of Australia representative on the Council of Financial Regulators.

Mr Ian Macfarlane
(non-executive, ex officio)
BEc (Hons), MEc (Monash), FASSA

Governor and Chairman of the Board of the Reserve Bank of Australia, Chairman of the Payments System Board and the Council of Financial Regulators.

Mr Don Mercer
(non-executive)
BSc (Hons 1) (St Andrews), Dip Pub Admin,
MA (Econ) (Manchester)

Previously Group Managing Director and Chief Executive Officer of ANZ, with extensive experience in the banking and oil industries.
Chair of the Risk Management and Audit Committee.

Mrs Marian Micalizzi
(non-executive)
BBus (QUT), FCA, MAICD

Previously a director of Australian Financial Institutions Commission and the Queensland Office of Financial Supervision and a member of several advisory boards and panels, including the Takeovers Panel.

## New governance structure

The new governance structure for APRA involves the replacement of the APRA Board with a full-time executive group comprising at least three and no more than five members. The executive group is to carry the responsibility and be accountable for the operation and performance of APRA.

Amendments to the APRA Act have also clarified APRA's 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, as before, required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

APRA's responsibility for development of administrative practices and procedures includes 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.

**Members' attendance at meetings from 1 July 2002 to 30 June 2003**

| | Board meetings | | Risk Management and Audit Committee (c) | |
|---|---|---|---|---|
| | (a) | (b) | (a) | (b) |
| Dr Jeffrey Carmichael | 12 | 12 | – | – |
| Mr Graeme Thompson | 12 | 12 | – | – |
| Dr David Knox | 12 | 12 | 4 | 4 |
| Dr John Laker | 12 | 12 | – | – |
| Mr Ian Macfarlane | 12 | 12 | – | – |
| Mr Don Mercer | 12 | 12 | 4 | 4 |
| Mrs Marian Micalizzi | 12 | 12 | 4 | 4 |
| Mr Rod Atfield | 12 | 12 | 4 | 4 |
| Professor Berna Collier | 12 | 10 | – | – |

(a) number of meetings held during the period;
(b) number of meetings attended; and
(c) APRA's external auditor, the Auditor-General, has a representative who attends these meetings by invitation.

## Risk assessment and internal audit

The Risk Assessment and Internal Audit unit plays an important role in APRA's corporate governance, assurance and compliance framework. The unit assists APRA members (and, before 1 July 2003, the APRA Board) and senior management to identify and understand risks facing APRA by providing APRA's Risk Management and Audit Committee with a summary of high and significant risks at the organisational level. Risk management strategies to mitigate these risks are also documented as part of the organisation's risk profile that is re-assessed every six months.

Risk assessment and internal audit staff utilise an ongoing process consistent with the Australian/New Zealand standard on risk management (AS/NZS 4360:1999). Regular risk assessment and audit reports to senior management and the Risk Management and Audit Committee include risk identification and analysis and associated risk management strategies and action plans. During the reporting period, a program of independent internal audits approved by the Chief Executive Officer and endorsed by the Risk Management and Audit Committee was conducted, providing ongoing assurance regarding the organisation's key areas of internal control. This program included reviews of internal and external compliance.

Fraud risk management is an ongoing focus within APRA, with fraud control reviews and training included in the 2002/2003 Strategic Internal Audit Plan. There were no incidents of fraud reported for the year.

Following the change in APRA's governance arrangements, a new Risk Management and Audit Committee has been established. Its membership, charter and attendance will be included in reporting for the next period.

# APRA MEMBERS

**Dr John Laker**
CHAIRMAN AND MEMBER
BEc (Hons 1) (Syd), MSc PhD (London)

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). Dr Laker is APRA's representative on the RBA's Payments System Board and on the Council of Financial Regulators.

**Mr (Kerry) Ross Jones**
DEPUTY CHAIRMAN AND MEMBER
BA, MCom (Newcastle)

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

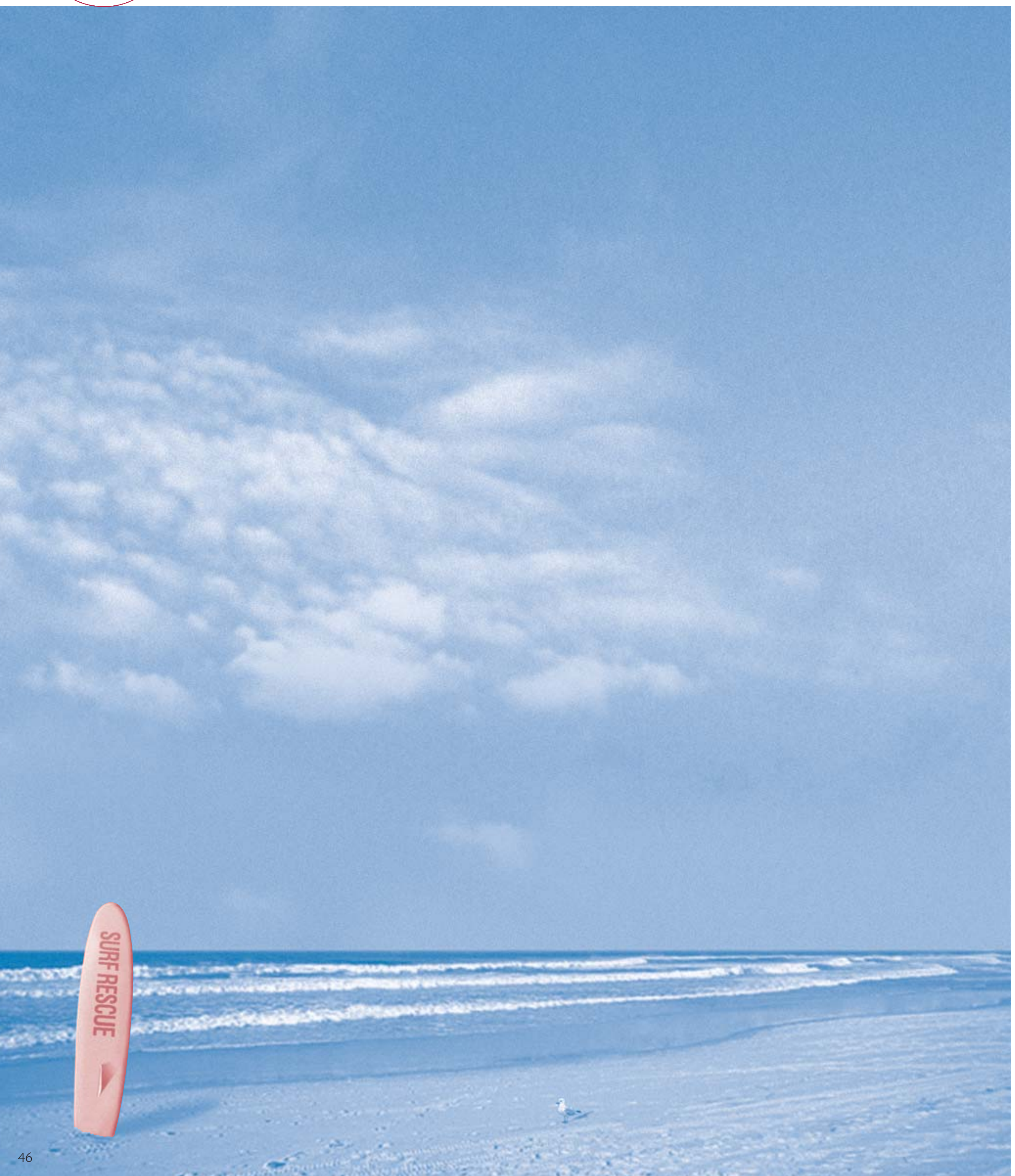
Mr Jones held the position of Commissioner at the Australian Competition and Consumer Commission (ACCC) with responsibilities for mergers and acquisitions and telecommunications. Mr Jones has worked as an economic consultant to the private and public sector and undertaken extensive work with the ACCC, 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**
MEMBER
MSc (Melb) SM (MIT), FIAA, FIA (UK), ASA (USA), FAICD

Mr Steve Somogyi was appointed as a Member of APRA for a three-year term, and took up his position in September 2003.

Mr Somogyi has over thirty 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. Since 1998, he has held a number of positions including Chief Financial Officer of Mayne Nickless Limited and Chief Executive Officer of the CPI Group Limited.

# 8 Financial statements








# Statement by Members

In my opinion, the attached financial statements for the year ended 30 June 2003 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 my 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.

Signed

*Dr John F. Laker*
Chairman

18 September 2003

# Statement of Financial Performance

for the year ended 30 June 2003

| | Note | 2003 $'000 | 2002 $'000 |
|---|---|---|---|
| **Revenue** | | | |
| **Revenues from ordinary activities** | | | |
| Revenue from Government | 5A | **61,152** | 57,196 |
| Goods and services | 5B | **2,906** | 1,331 |
| Interest | 5C | **1,114** | 1,033 |
| Revenue from sale of assets | 5D | **1** | – |
| Insurance recoveries and other revenue | 5E | **3,283** | 2,636 |
| **Total revenues from ordinary activities** | | **68,456** | 62,196 |
| **Expenses** | | | |
| **Expenses from ordinary activities** | | | |
| Employees | 6A | **40,951** | 34,393 |
| Suppliers | 6B | **23,995** | 20,297 |
| Depreciation and amortisation | 6C | **3,489** | 2,831 |
| Write-down of assets | 6D | **4** | 1,602 |
| Value of assets sold | 6E | **185** | 108 |
| **Total expenses from ordinary activities** | | **68,624** | 59,231 |
| **Net operating surplus (deficit) from ordinary activities** | 11 | **(168)** | 2,965 |
| **Total changes in equity other than those resulting from transactions with owners as owners** | | **(168)** | 2,965 |

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



AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

# Statement of Financial Position

as at 30 June 2003

| | Note | 2003 $'000 | 2002 $'000 |
|---|---|---|---|
| **Assets** | | | |
| **Financial assets** | | | |
| Cash | 7A | **10,815** | 10,416 |
| Receivables | 7B | **5,162** | 2,059 |
| **Total financial assets** | | **15,977** | 12,475 |
| **Non-financial assets** | | | |
| Infrastructure, plant and equipment | 8A,C | **5,542** | 6,108 |
| Intangibles | 8B,C | **6,540** | 6,886 |
| Other | 8D | **294** | 330 |
| **Total non-financial assets** | | **12,376** | 13,324 |
| **Total assets** | | **28,353** | 25,799 |
| **Liabilities** | | | |
| **Payables** | | | |
| Suppliers | 9A | **2,970** | 2,905 |
| Other payables | 9B | **14** | 25 |
| Revenue in advance | 9C | **2,000** | 976 |
| **Total payables** | | **4,984** | 3,906 |
| **Provisions** | | | |
| Employees | 10A | **12,280** | 10,463 |
| Other | 10B | **1,998** | 2,175 |
| **Total provisions** | | **14,278** | 12,638 |
| **Total liabilities** | | **19,262** | 16,544 |
| **Equity** | | | |
| Contributed equity | 11 | **5,255** | 5,255 |
| Reserves | 11 | **487** | 483 |
| Accumulated surpluses | 11 | **3,349** | 3,517 |
| **Total equity** | 11 | **9,091** | 9,255 |
| **Current assets** | | **16,271** | 12,805 |
| **Non-current assets** | | **12,082** | 12,994 |
| **Current liabilities** | | **12,842** | 10,483 |
| **Non-current liabilities** | | **6,420** | 6,061 |

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

# Statement of Cash Flows

for the year ended 30 June 2003

| | Note | 2003 $'000 | 2002 $'000 |
|---|---|---|---|
| **Operating activities** | | | |
| **Cash received** | | | |
| Appropriations | | **59,875** | 58,365 |
| Goods and services[1] | | **2,635** | 1,538 |
| Interest | | **1,122** | 1,057 |
| Insurance recovery[2] | | **2,682** | 2,039 |
| GST recovered from ATO | | **2,165** | 2,806 |
| **Total cash received** | | **68,479** | 65,805 |
| **Cash used** | | | |
| Employees | | **(39,135)** | (38,095) |
| Suppliers | | **(26,185)** | (20,927) |
| **Total cash used** | | **(65,320)** | (59,022) |
| **Net cash from operating activities** | 12 | **3,159** | 6,783 |
| **Investing activities** | | | |
| **Cash received** | | | |
| Proceeds from sale of plant and equipment | | **1** | – |
| **Total cash received** | | **1** | – |
| **Cash used** | | | |
| Purchase of plant and equipment | | **(1,260)** | (3,044) |
| Purchase of financial instruments | | **–** | – |
| Purchase of intangibles | | **(1,501)** | (1,680) |
| **Total cash used** | | **(2,761)** | (4,724) |
| **Net cash used by investing activities** | | **(2,760)** | (4,724) |
| **Financing activities** | | | |
| **Cash used** | | | |
| Repayments of debt | | **–** | (5,439) |
| **Total cash used** | | **–** | (5,439) |
| **Net cash used by financing activities** | | **–** | (5,439) |
| **Net increase/(decrease) in cash held** | | **399** | (3,380) |
| Cash at the beginning of the reporting period | | **10,416** | 13,796 |
| **Cash at the end of the reporting period** | 7A | **10,815** | 10,416 |

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

1 Prior year amount restated to include $846,000 previously classed as other.
2 Prior year amount restated from sales of goods and services.



AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

# Schedule of Commitments

as at 30 June 2003

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **By type[3,4]** | | |
| **Commitments payable** | | |
| Operating leases[5] | **25,142** | 31,833 |
| **Total commitments payable** | **25,142** | 31,833 |
| **Commitments receivable** | | |
| Operating subleases[6] | **(3,475)** | (6,378) |
| **Total commitments receivable** | **(3,475)** | (6,378) |
| **Net commitments** | **21,667** | 25,455 |
| **By maturity** | | |
| **Net commitments** | | |
| One year or less | **4,875** | 4,484 |
| From one to five years | **16,091** | 17,095 |
| Over five years | **701** | 3,876 |
| **Total net commitments** | **21,667** | 25,455 |

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

3 Commitments are GST inclusive where relevant.
4 APRA has no capital commitments.
5 Operating leases are effectively non-cancellable and comprise:
– leases for office accommodation;
– photocopier lease and copy charges; and
– leases for motor vehicles.
6 Operating subleases commitments receivable comprise amounts receivable from other bodies for subleasing of office accommodation.

# Schedule of Contingencies

as at 30 June 2003

## Contingent liabilities

There were no quantifiable contingent liabilities at 30 June 2003 (2002: $nil).

## Unquantifiable contingencies

At 30 June 2003, APRA had a number of legal matters outstanding that APRA is defending. It is not possible to estimate the amounts of any eventual payments that may be required in relation to these claims.

Estimated costs incurred during the year associated with other legal action, currently under way, are reflected in the *Statement of Financial Performance*.

The above schedules should be read in conjunction with the accompanying notes.





# Schedule of Administered Items

| | Note | 2003 $'000 | 2002 $'000 |
|---|---|---|---|
| **Revenues administered on behalf of Government** | | | |
| *for the year ended 30 June* | | | |
| **Taxation revenue** | | | |
| Financial institutions supervisory levies | 19A | **79,444** | 92,818 |
| **Non-taxation revenue** | | | |
| Refunds by APRA of overpayments by institutions | 19A | **–** | 766 |
| **Total revenues administered on behalf of Government** | | **79,444** | 93,584 |
| **Expenses administered on behalf of Government** | | | |
| *for the year ended 30 June* | | | |
| Levy waivers and write-offs | 4F,4G,19B | **379** | 873 |
| **Total expenses administered on behalf of Government** | | **379** | 873 |
| **Assets administered on behalf of Government** | | | |
| *as at 30 June* | | | |
| **Financial assets** | | | |
| Cash | 19C | **1,930** | – |
| Receivables | 19C | **209** | 737 |
| Accrued revenue | 19C | **20** | 78 |
| **Total assets administered on behalf of Government** | | **2,159** | 815 |
| **Liabilities administered on behalf of Government** | | | |
| *as at 30 June* | | | |
| **Financial liabilities** | | **–** | – |
| **Administered cash flows** | | | |
| *for the year ended 30 June* | | | |
| **Operating activities** | | | |
| **Cash received** | | | |
| Financial institutions supervisory levies | | **78,982** | 89,166 |
| Cash received from Official Public Account for refunds | | **231** | – |
| **Total cash received** | | **79,213** | 89,166 |
| **Cash used** | | | |
| Cash transferred to Official Public Account | | **(77,052)** | (89,166) |
| Refunds of overpayment of supervisory levies | | **(231)** | – |
| **Total cash used** | | **(77,283)** | (89,166) |
| **Net cash from operating activities** | | **1,930** | – |
| Cash at the beginning of the reporting period | | **–** | – |
| **Cash at the end of the reporting period** | | **1,930** | – |

# Notes to and Forming Part of the Financial Statements

for the year ended 30 June 2003

| Note | Description |
|---|---|
| 1 | Summary of significant accounting policies |
| 2 | Economic dependency |
| 3 | Events occurring after reporting date |
| 4 | Financial institutions supervisory levies |
| 5 | Operating revenues |
| 6 | Operating expenses |
| 7 | Financial assets |
| 8 | Non-financial assets |
| 9 | Payables |
| 10 | Provisions |
| 11 | Equity |
| 12 | Cash flow reconciliation |
| 13 | Remuneration of Board Members |
| 14 | Related party disclosures |
| 15 | Remuneration of officers |
| 16 | Remuneration of auditors |
| 17 | Average staffing levels |
| 18 | Financial instruments |
| 19 | Administered items |
| 20 | Appropriations |
| 21 | Assets held in trust |
| 22 | Special account |
| 23 | Reporting of outcomes |



## Note 1. Summary of significant accounting policies

### 1.1 Basis of accounting

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 statements have been prepared in accordance with:

- Finance Minister's Orders (FMOs) being the *Commonwealth Authorities and Companies (Financial Statements for reporting periods ending on or after 30 June 2003) Orders;*
- Australian Accounting Standards and Accounting Interpretations issued by the Australian Accounting Standards Board; and
- Consensus Views of the Urgent Issues Group.

APRA's *Statement of Financial Performance* and *Statement of Financial Position* 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 valuation. Except where stated, no allowance is made for the effect of changing prices on the results or the financial position.

Assets and liabilities are recognised in APRA's *Statement of Financial Position* 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. Assets and liabilities arising under agreements equally proportionately unperformed are however 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*.

Revenues and expenses are recognised in APRA's *Statement of Financial Performance* when and only when the flow or consumption or loss of economic benefits has occurred and can be reliably measured.

#### Administered items

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 1.18.

Administered transactions relate to the levies, late lodgement and late payment penalties collected under the *Financial Institutions Supervisory Levies Collection Act 1998*.

While the revenues from these levies are in part used to fund the operations of APRA, they are first remitted to the Commonwealth's Official Public Account. A certain amount, as specified by the Treasurer in an annual Determination made under section 50(2) of the *Australian Prudential Regulation Authority Act 1998*, is retained in the Consolidated Revenue Fund to fund the Australian Securities and Investments Commission for consumer protection and market integrity functions, and the Australian Taxation Office for unclaimed moneys and lost member functions. The balance is drawn down by APRA under a special appropriation.

### 1.2 Changes in accounting policy

The accounting policies used in the preparation of these financial statements are consistent with those used in 2001/02, except in respect of valuation of *Property (infrastructure), plant and equipment* as stated in Note 1.11.

### 1.3 Revenue

#### (a) Revenues from Government – appropriations

APRA is funded primarily through levies paid by the industries it regulates. The levies raised are transferred to APRA via a special appropriation, the amount transferred being net of the amount specified in the Treasurer's Determination to be retained in the Consolidated Revenue Fund (CRF) to fund consumer protection, market integrity, unclaimed moneys and lost member functions.

APRA revenue reflects its performance in managing the levy process, being reduced by any waivers or write-offs of debt.

The full amount of the appropriation for departmental outputs for the year is recognised as revenue except in relation to the annual appropriation for the HIH Royal Commission, which is recognised at a rate corresponding to the rate of expenses incurred.

## Note 1. Summary of significant accounting policies (continued)

### 1.3 Revenue (continued)

(b) Revenue from other sources

Revenue, if any, from the sale of goods is recognised upon the delivery of goods to customers.

Interest revenue is recognised on a proportional basis taking into account the interest rates applicable to the financial assets.

Revenue from disposal of non-current assets is recognised when control of the asset has passed to the buyer.

Revenue from the rendering of a service is recognised by reference to the stage of completion of contracts or other agreements to provide services. The stage of completion is determined according to the proportion that costs incurred to date bear to the estimated total costs of the transaction.

(c) 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 2002/03 (2001/02: $nil).

(d) Insurance recoveries and other revenue

Revenue recognised as insurance recoveries represent the costs received from the liability insurer for costs that APRA has incurred in preparing submissions for the HIH Royal Commission. Expenditure for the HIH Royal Commission is represented under suppliers' expenses.

### 1.4 Transactions by the Government as owner

Appropriations to APRA designated as equity injections are recognised as contributed equity in accordance with the FMOs.

### 1.5 Employee benefits

(a) Benefits

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

Liabilities for salaries (including non-monetary benefits) and annual leave are measured at their nominal amounts. Other employee benefits expected to be settled within 12 months of their reporting date are also 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.

(b) Leave

The liability for employee entitlements 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 employee's remuneration, including the Authority's employer superannuation contribution to the extent that the leave is likely to be taken during service rather than paid out on termination.

The liability for the non-current portion of long service leave is 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. In determining the present value of the liability, APRA has taken into account attrition rates and pay increases through promotion and inflation.



### 1.5 Employee benefits (continued)

(c) Separation and redundancy

Provision is made for separation and redundancy 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.

(d) Superannuation

APRA employees contribute to the Commonwealth Superannuation Scheme, the Public Sector Superannuation Scheme, and the Reserve Bank Officers' Superannuation Fund. In addition, employer contributions are made to other superannuation funds, as nominated by the employee (see Note 6A).

No liability for superannuation benefits is recognised as at 30 June as the employer contributions fully extinguish the accruing liability that is assumed by the Commonwealth, or by the other funds, as appropriate.

### 1.6 Leases

A distinction is made between finance leases, which effectively transfer from the lessor to the lessee substantially all the risks and benefits incidental to ownership of leased non-current assets, and operating leases under which the lessor effectively retains all such risks and benefits.

Where a non-current asset is acquired by means of a finance lease, the asset is capitalised at the present value of minimum lease payments at the inception of the lease and a liability recognised for the same amount. 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 basis which is representative of the pattern of benefits derived from the leased assets. The net present value of future net outlays in respect of surplus space under non-cancellable lease agreements is expensed in the period in which the space becomes surplus.

Lease incentives taking the form of "free" leasehold improvements and rent holidays are recognised as liabilities. These liabilities are reduced by allocating lease payments between rental expense and the reduction of the liability.

As at 30 June 2003, there were no finance leases current (2002: $nil).

### 1.7 Borrowing costs

All borrowing costs are expensed as incurred except to the extent that they are directly attributable to qualifying assets, in which case they are capitalised. The amount capitalised in a reporting period does not exceed the amounts of costs incurred in that period.

APRA has no qualifying assets for which funds were borrowed specifically in 2002/03 (2001/02: $nil).

### 1.8 Cash

Cash includes:

- cash at bank;
- petty cash;
- deposits at call; and
- Commonwealth and State Government securities (held for a maximum of 90 days).

### 1.9 Financial instruments

Accounting policies in relation to financial instruments are stated at Note 18.

## Note 1. Summary of significant accounting policies (continued)

### 1.10 Acquisition of assets

Assets are recorded at cost of acquisition except as stated below. The cost of acquisition includes the fair value of assets transferred in exchange and liabilities undertaken.

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.

### 1.11 Property (infrastructure), plant and equipment

#### (a) Asset recognition threshold

Purchases of plant and equipment are recognised initially at cost in the *Statement of Financial Position*, except for purchases costing less than $3,000 and all desk top computers, which are expensed in the year of acquisition.

#### (b) Revaluations

Infrastructure, plant and equipment are carried at valuation. Revaluations undertaken up to 30 June 2002 were done on a deprival basis; revaluations since that date are at fair value. This change in accounting policy is required by Australian Accounting Standard AASB1041 Revaluation of Non-Current Assets.

Fair and deprival values for each class of assets are determined as shown below.

| Asset Class | Fair value measured at: | Deprival value measured at: |
|---|---|---|
| Leasehold improvements | Depreciated replacement cost | Depreciated replacement cost |
| Computer hardware and office equipment | Market selling price | Depreciated replacement cost |

Under both deprival and fair value, assets which are surplus to requirement are measured at their net realisable value.
At 30 June 2003, APRA held no surplus assets. (30 June 2002: $nil)

No revaluations to fair value were carried out during the year therefore this change in policy has had no effect on asset values in the year 2002/03.

#### (c) Frequency

Infrastructure, plant and equipment were revalued progressively over three years, concluding with 2002/03. With the commencement of the next cycle in 2003/04 it is proposed to revalue all infrastructure, plant and equipment and leasehold improvements assets in that year and then maintain annual revaluations on all fixed assets.

Assets in each class acquired after commencement of the revaluation cycle are not captured by the progressive revaluation then in progress.

#### (d) Conduct

All valuations are conducted by an independent qualified valuer.



### 1.11 Property (infrastructure), plant and equipment (continued)

#### (e) Recoverable amount test

From 1 July 2002, the FMOs no longer require the application of the recoverable amounts test in AAS 10 Recoverable Amount of Non-Current Assets to the assets of authorities when the primary purpose of the asset is not the generation of net cash inflows.

No infrastructure, plant and equipment assets have been written to recoverable amount as per AAS10. Accordingly the change in policy has had no financial effect.

#### (f) Depreciation and amortisation

Depreciable computer hardware and office 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 balance date and necessary adjustments are recognised in the current, or current and future reporting periods, as appropriate. Residual values are re-estimated for a change in prices only when assets are revalued.

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

| | 2003 | 2002 |
|---|---|---|
| Computer hardware and office equipment | **3 to 12 years** | 3 to 12 years |
| Leasehold improvements | **Lower of 10 years or lease term** | Lower of 10 years or lease term |

The aggregate amount of depreciation allocated for each class of asset during the reporting period is disclosed in Note 6C.

### 1.12 Intangibles

APRA's intangibles comprise internally developed software and purchased software for internal use. The asset is carried at cost.

From 1 July 2002, the FMOs no longer require the application of the recoverable amount test in Australian Accounting Standard AAS10 Recoverable Amount of Non-Current Assets to the assets of authorities when the primary purpose of the asset is not the generation of net cash inflows.

However, the FMOs now require such assets, if carried on the cost basis, to be assessed for indications of impairment. The carrying amount of impaired assets must be written down to the higher of its net market selling price or depreciated replacement cost.

All software assets were assessed for impairment as at 1 July 2002. None was found to be impaired.

Intangibles are recognised initially at cost in the *Statement of Financial Position*, except for items costing less than $3,000.

Software assets are amortised on a straight-line basis over their anticipated useful lives:

| | 2003 | 2002 |
|---|---|---|
| Internally developed software | **Lesser of 5 years or assessed useful life** | 5 years |
| Purchased software | **Lesser of 5 years or assessed useful life** | 5 years |

### 1.13 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.

## Note 1. Summary of significant accounting policies (continued)

### 1.14 Foreign currency

Transactions denominated in a foreign currency are converted at the exchange rate at the date of the transaction. Foreign currency receivables and payables are translated at the exchange rates current as at balance date. Associated currency gains and losses are not material.

### 1.15 Insurance

APRA has insured for risks through the Government's insurable risk managed fund Comcover. Workers compensation is insured through Comcare Australia.

### 1.16 Comparative figures

Comparative figures have been adjusted to conform to changes in presentation in these financial statements where required.

### 1.17 Rounding

Amounts have been rounded to the nearest $1,000, except in relation to the following:

- remuneration of Board Members;
- remuneration of officers (other than Board Members); and
- remuneration of auditors.

### 1.18 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 other Authority items, including the application to the greatest extent possible of accounting standards, accounting interpretations and UIG consensus views.

Administered revenues transferred or transferable to the Official Public Account are not reported as administered expenses or payables. These transactions or balances are internal to the administered entity.

Transfers of cash are reported as administered (operating) cash flows.

All administered revenues are revenues relating to the core operating activities performed by the Authority on behalf of the Commonwealth. Administered revenue arising from levies on superannuation entities is recognised upon issue of invoice while administered revenue in respect of levies on all other non-superannuation entities is recognised on the date it becomes due and payable to APRA or on the date the payment is received, whichever occurs first.

## Note 2. Economic dependency

APRA was established pursuant to the *Australian Prudential Regulation Authority Act 1998* as a separate legal entity of the Commonwealth of Australia. APRA is dependent on Government policy, and on continuing appropriations by Parliament for APRA's administration and programs. These appropriations are primarily derived from levies on the institutions that APRA regulates (see Note 1.3).

## Note 3. Events occurring after reporting date

No events occurring after balance date were noted.

## Note 4. Financial institutions supervisory levies

This Note provides details on APRA's management of current and prior year levies collected under the *Financial Institutions Supervisory Levies Collection Act 1998* which, in turn, determines APRA's revenue from Government through a special appropriation under the APRA Act.



| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Note 4A. Summary** | | |
| Annual levies on APRA-regulated institutions (see Note 4B) | **74,643** | 69,832 |
| Add: Late payment penalties (see Note 4C) | **66** | 115 |
| Add: Late lodgement penalties (see Note 4D) | **24** | 156 |
| **Levy revenue to the Commonwealth (see Note 4E)** | **74,733** | 70,103 |
| Less: Waivers and write-offs (see Notes 4F and 4G) | **(379)** | (873) |
| Levy revenue net of waivers and write-offs (see Note 4H) | **74,354** | 69,230 |
| Less: Amounts retained in the Consolidated Revenue Fund (see Note 4I) | **(14,668)** | (14,668) |
| **Funding of APRA by special appropriation (see Note 4J)** | **59,686** | 54,562 |
| **Note 4B. Annual levies on APRA-regulated institutions** | | |
| Superannuation funds | **30,512** | 28,570 |
| Authorised deposit-taking institutions | **23,753** | 23,464 |
| Life insurers and friendly societies | **9,044** | 8,751 |
| General insurers | **11,260** | 8,939 |
| Retirement savings account providers | **74** | 108 |
| **Total annual levies** | **74,643** | 69,832 |
| **Note 4C. Late payment penalties** | | |
| Superannuation funds | **66** | 115 |
| **Total late payment penalties** | **66** | 115 |
| **Note 4D. Late lodgement penalties** | | |
| Superannuation funds | **24** | 156 |
| **Total late lodgement penalties** | **24** | 156 |
| **Note 4E. Total levy revenue to the Commonwealth** | | |
| Superannuation funds | **30,602** | 28,841 |
| Authorised deposit-taking institutions | **23,753** | 23,464 |
| Life insurers and friendly societies | **9,044** | 8,751 |
| General insurers | **11,260** | 8,939 |
| Retirement savings account providers | **74** | 108 |
| **Total levy revenue to the Commonwealth** | **74,733** | 70,103 |

## Note 4. Financial Institutions Supervisory Levies (continued)

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Note 4F. Levies waived by APRA on behalf of the Commonwealth** | | |
| Superannuation funds | **(255)** | (370) |
| General insurers | **(2)** | (182) |
| **Total levies waived** | **(257)** | (552) |
| **Note 4G. Levies written-off by APRA on behalf of the Commonwealth** | | |
| Superannuation funds | **(61)** | (321) |
| Life insurers and friendly societies | **(61)** | – |
| **Total levies written-off** | **(122)** | (321) |
| **Note 4H. Levy revenue net of waivers and write-offs** | | |
| Superannuation funds | **30,286** | 28,150 |
| Authorised deposit-taking institutions | **23,753** | 23,464 |
| Life insurers and friendly societies | **8,983** | 8,751 |
| General insurers | **11,258** | 8,757 |
| Retirement savings account providers | **74** | 108 |
| **Total levy revenue net of waivers and write-offs** | **74,354** | 69,230 |
| **Note 4I. Amounts retained in the Consolidated Revenue Fund (see Note 1.1)** | | |
| Superannuation funds | **(8,348)** | (8,348) |
| Authorised deposit-taking institutions | **(2,560)** | (2,560) |
| Life insurers and friendly societies | **(2,040)** | (2,040) |
| General insurers | **(1,720)** | (1,720) |
| **Total levy amount retained in CRF** | **(14,668)** | (14,668) |
| **Note 4J. APRA special appropriation for 2002/03 levies** | | |
| Superannuation funds | **21,938** | 19,802 |
| Authorised deposit-taking institutions | **21,193** | 20,904 |
| Life insurers and friendly societies | **6,943** | 6,711 |
| General insurers | **9,538** | 7,037 |
| Retirement saving account providers | **74** | 108 |
| **Total APRA special appropriation for 2002/03 levies** | **59,686** | 54,562 |



## Note 5. Operating revenues

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Note 5A. Revenues from Government** | | |
| Special appropriation levies (see Notes 4A and 4J) | **59,686** | 54,562 |
| Annual appropriation[7] | **–** | 6,100 |
| Annual appropriation 2001/02 brought forward | **966** | – |
| Annual appropriation 2001/02 re-issued[8] | **2,500** | – |
| Unearned annual appropriation (see Note 9C) | **(2,000)** | (966) |
| Return of appropriation[9] | **–** | (2,500) |
| **Total revenues from Government** | **61,152** | 57,196 |
| **Note 5B. Sales of goods and services** | | |
| Goods | **–** | – |
| Fees for service | **1,228** | 157 |
| Rent recoveries | **1,084** | 846 |
| Miscellaneous other services | **594** | 328 |
| **Total sales of goods and services** | **2,906** | 1,331 |
| **Rendering of services to:** | | |
| Related entities | **1,148** | 372 |
| External entities | **1,758** | 959 |
| **Total rendering of goods and services** | **2,906** | 1,331 |
| **Note 5C. Interest revenue** | | |
| Deposits | **537** | 530 |
| Commonwealth and State Government securities | **577** | 503 |
| **Total interest revenue** | **1,114** | 1,033 |
| **Note 5D. Proceeds from disposal of assets** | | |
| Infrastructure, plant and equipment | | |
| Proceeds from disposal | **1** | – |
| Net book value of assets disposed | **(5)** | – |
| Write-offs | **(181)** | (108) |
| **Net gain/(loss) from disposal of infrastructure, plant and equipment** | **(185)** | (108) |
| **Note 5E. Insurance recoveries and other revenue** | | |
| Insurance recoveries from liability insurer for costs associated with the HIH Royal Commission | **3,273** | 2,517 |
| Other revenue relating to recovery of prior year court costs and prior year compensation matters | **10** | 119 |
| **Total insurance recoveries and other revenue** | **3,283** | 2,636 |

7 Annual appropriation of $4 million for HIH Royal Commission and $2.1m for increased supervision of superannuation activities.

8 Appropriation of $2.5 million initially received in 2001/02 for the HIH Royal Commission was returned to CRF in June 2002. The amount was subsequently re-issued for ongoing costs associated with the implementation of the recommendations of the HIH Royal Commission.

9 $500,000 of the re-issued $2.5 million was redrawn and recognised as revenue in 2002/03, with the balance of $2 million being accounted for as unearned appropriation revenue.

## Note 6. Operating expenses

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Note 6A. Employee expenses** | | |
| Wages and salaries | **34,152** | 27,947 |
| Superannuation | **3,139** | 1,633 |
| Leave and other entitlements | **1,848** | 3,604 |
| Separation and redundancy | **83** | 34 |
| Other employee expenses | **1,456** | 1,144 |
| **Total employee benefits expenses** | **40,678** | 34,362 |
| Workers' compensation premiums | **273** | 31 |
| **Total employee expenses** | **40,951** | 34,393 |

**Superannuation**

APRA contributes to the Commonwealth Superannuation (CSS), Public Sector Superannuation (PSS) schemes and Reserve Bank Officer' Superannuation Fund (RBOSF), which provide retirement, death and disability benefits to 23 per cent of its employees, previously employed by APRA's antecedent bodies. Contributions to the schemes are at rates calculated to cover existing and emerging obligations. Current contribution rates are 16 per cent of salary (CSS), 11.0 per cent of salary (PSS) and 3 per cent of salary (RBOSF). An additional 3 per cent is contributed for employer productivity benefits. Each of these schemes is closed to new APRA contributors. Employer contributions amounting to $832,801 (2001/02: $822,290) in relation to these schemes have been expensed in these financial statements. Employer superannuation productivity benefit contributions totalled $201,480 (2001/02: $219,392).

Contributions on behalf of the balance of staff are made to various complying superannuation funds in accordance with the *Superannuation Guarantee (Administration) Act 1992*.

### Note 6B. Supplier expenses

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| Goods from related entities | **–** | – |
| Goods from external entities | **1,854** | 1,563 |
| Services from related entities | **1,874** | 1,993 |
| Services from external entities [10] | **15,057** | 11,698 |
| Operating lease rentals | **5,210** | 5,043 |
| **Total supplier expenses** | **23,995** | 20,297 |

10 Includes expenses of $3.69 million (2001/02: $3.034 million) associated with HIH Royal Commission.



### Note 6C. Depreciation and amortisation

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| Depreciation of infrastructure, plant and equipment | **1,642** | 1,497 |
| Amortisation of intangibles | **1,847** | 1,334 |
| **Total depreciation and amortisation** | **3,489** | 2,831 |

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

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| Computer hardware and office equipment | **865** | 784 |
| Leasehold improvements | **777** | 713 |
| Intangibles | **1,847** | 1,334 |
| **Total depreciation and amortisation** | **3,489** | 2,831 |

### Note 6D. Write-down of assets

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| Infrastructure, plant and equipment – write-off | **4** | – |
| Intangibles – work-in-progress write-down | **–** | 1,602 |
| **Total write-down of assets** | **4** | 1,602 |

### Note 6E. Value of assets sold

**Non-financial assets**

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| Cost of infrastructure, plant and equipment disposed (Note 5D) | **185** | 108 |
| **Net book value of assets disposed** | **185** | 108 |

## Note 7. Financial assets

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Note 7A. Cash** | | |
| Cash at bank and on hand | **10,809** | 10,408 |
| Deposits at call | **6** | 8 |
| **Total cash** | **10,815** | 10,416 |
| **Note 7B. Receivables** | | |
| Special appropriation | **1,135** | 889 |
| Less: Provision for doubtful debt related to outstanding levy debt | **(12)** | (74) |
| Annual appropriation 2001/02 re-issued | **2,000** | – |
| Net appropriations | **3,123** | 815 |
| Goods and services | **439** | 184 |
| Less: provision for doubtful debts | **(2)** | (2) |
| Net goods and services | **437** | 182 |
| Insurance recoveries | **1,198** | 600 |
| Accrued interest receivable | **44** | 53 |
| GST receivable | **360** | 409 |
| **Total receivables (net)** | **5,162** | 2,059 |
| All receivables are current assets | | |
| **Receivables (gross) are aged as follows:** | | |
| Not overdue | **4,801** | 1,944 |
| Overdue by: | | |
| – less than 30 days | **337** | 108 |
| – 30 to 60 days | **2** | 2 |
| – 60 to 90 days | **9** | 3 |
| – more than 90 days | **27** | 78 |
| | **375** | 191 |
| **Total receivables (gross)** | **5,176** | 2,135 |
| **The provision for doubtful debts is aged as follows:** | | |
| Not overdue | **–** | – |
| Overdue by: | | |
| – less than 30 days | **–** | – |
| – 30 to 60 days | **(2)** | (4) |
| – 60 to 90 days | **(5)** | (3) |
| – more than 90 days | **(7)** | (69) |
| **Total provision for doubtful debts** | **(14)** | (76) |
| **Total receivables (net)** | **5,162** | 2,059 |



## Note 8. Non-financial assets

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Note 8A. Infrastructure, plant and equipment** | | |
| Computer hardware and office equipment | | |
| – at cost | **1,908** | 1,144 |
| – accumulated depreciation | **(354)** | (262) |
| | **1,554** | 882 |
| – at 2001/2004 valuation (deprival value) | **2,286** | 2,439 |
| – accumulated depreciation | **(2,061)** | (1,428) |
| | **225** | 1,011 |
| **Total computer hardware and office equipment** | **1,779** | 1,893 |
| **Leasehold improvements** | | |
| – at cost | **2,373** | 1,876 |
| – accumulated depreciation | **(105)** | (510) |
| | **2,268** | 1,366 |
| – at 2001/2004 valuation (deprival value) | **5,538** | 5,832 |
| – accumulated depreciation | **(4,043)** | (2,983) |
| | **1,495** | 2,849 |
| **Total leasehold improvements** | **3,763** | 4,215 |
| **Total infrastructure, plant and equipment ( non-current )** | **5,542** | 6,108 |

The revaluations performed in 2000/01 were in accordance with the revaluation policy stated at Note 1.11 – property (infrastructure), plant and equipment and were completed by an independent valuer, the Australian Valuation Office.

## Note 8. Non-financial assets (continued)

### Note 8B. Intangibles

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| Computer software – received free of charge – at fair value | **–** | 128 |
| Accumulated amortisation | **–** | (127) |
| | **–** | 1 |
| Computer software – internally developed – at cost | **7,269** | 6,334 |
| Accumulated amortisation | **(2,135)** | (862) |
| | **5,134** | 5,472 |
| Computer software – purchased – at cost | **1,717** | 1,475 |
| Accumulated amortisation | **(918)** | (591) |
| | **799** | 884 |
| Computer software – internally developed – deemed at cost (previously at valuation (1999)) | **969** | 1,925 |
| Accumulated amortisation | **(969)** | (1,868) |
| | **–** | 57 |
| Computer software – purchased – deemed at cost (previously at valuation (1999)) | **588** | 600 |
| Accumulated amortisation | **(578)** | (472) |
| | **10** | 128 |
| Computer software – internally developed – in progress – at cost | **597** | 344 |
| Accumulated amortisation | **–** | – |
| | **597** | 344 |
| **Total intangibles** | **6,540** | 6,886 |

### Note 8C. Analysis of infrastructure, plant, equipment and intangibles

**Table A – Reconciliation of the opening and closing balances of infrastructure, plant and equipment and intangibles**

| | Computer hardware and office equipment $'000 | Leasehold improvements $'000 | Intangibles $'000 | Total $'000 |
|---|---|---|---|---|
| **As at 1 July 2002** | | | | |
| Gross book value | 3,583 | 7,708 | 10,807 | 22,098 |
| Accumulated depreciation/amortisation | (1,690) | (3,493) | (3,921) | (9,104) |
| Net book value | 1,893 | 4,215 | 6,886 | 12,994 |
| Additions: | | | | |
| by purchase | 765 | 497 | 1,501 | 2,763 |
| Depreciation/amortisation expense | (864) | (777) | (1,848) | (3,489) |
| Disposals: | | | | |
| Other disposals | (15) | (171) | – | (186) |
| **As at 30 June 2003** | | | | |
| Gross book value | **4,194** | **7,911** | **11,141** | **23,246** |
| Accumulated depreciation/amortisation | **(2,415)** | **(4,148)** | **(4,601)** | **(11,164)** |
| Net book value | **1,779** | **3,763** | **6,540** | **12,082** |

| | $'000 | $'000 |
|---|---|---|

## Note 8. Non-financial assets (continued)

### Note 8C. Analysis of infrastructure, plant, equipment and intangibles (continued)

**Table B**
**Summary of balances of assets at valuation**

| | Infrastructure, plant and equipment |
|---|---|
| **As at 30 June 2003** | |
| Gross value | **7,824** |
| Accumulated depreciation/amortisation | **(6,104)** |
| Net book value | **1,720** |
| **As at 30 June 2002** | |
| Gross value | 8,271 |
| Accumulated depreciation/amortisation | (4,411) |
| Net book value | 3,860 |

**Table C**
**Summary of balances of assets under construction**

| | Computer software intangibles |
|---|---|
| **As at 30 June 2003** | |
| Gross value | **597** |
| Accumulated depreciation/amortisation | **–** |
| Net book value | **597** |
| **As at 30 June 2002** | |
| Gross value[11] | 344 |
| Accumulated depreciation/amortisation | – |
| Net book value | 344 |

### Note 8D. Other non-financial assets

| | 2003 | 2002 |
|---|---|---|
| Pre-payments | **294** | 330 |
| **Total other non-financial assets** | **294** | 330 |

11 Prior year amount restated to reflect elimination of computer hardware no longer classed as asset under construction.



| | 2003 $'000 | 2002 $'000 |
|---|---|---|

## Note 9. Payables

### Note 9A. Supplier payables

| | 2003 | 2002 |
|---|---|---|
| Trade creditors | **2,962** | 2,896 |
| Operating lease rentals | **8** | 9 |
| **Total supplier payables** | **2,970** | 2,905 |

All supplier payables are current.

### Note 9B. Other payables

| | 2003 | 2002 |
|---|---|---|
| GST payable to the Australian Taxation Office | **14** | 25 |
| **Total other payables** | **14** | 25 |

All other payables are current.

### Note 9C. Revenue in advance

| | 2003 | 2002 |
|---|---|---|
| Unearned annual appropriation revenue[12] (see Note 5A) | **2,000** | 966 |
| Other revenue in advance | **–** | 10 |
| **Total revenue in advance** | **2,000** | 976 |

All revenues in advance are current.

## Note 10. Provisions

### Note 10A. Employee provisions

| | 2003 | 2002 |
|---|---|---|
| Salaries and wages | **3,181** | 2,595 |
| Leave | **9,017** | 7,794 |
| Other | **82** | 74 |
| **Aggregate employee entitlements liability** | **12,280** | 10,463 |
| Current | **7,391** | 5,954 |
| Non-current | **4,889** | 4,509 |
| | **12,280** | 10,463 |

### Note 10B. Other provisions

| | 2003 | 2002 |
|---|---|---|
| Surplus leased space | **170** | 208 |
| Make good premises at lease end | **492** | 371 |
| Lease incentives | **1,336** | 1,596 |
| **Total other provisions** | **1,998** | 2,175 |
| Current | **468** | 623 |
| Non-current | **1,530** | 1,552 |
| | **1,998** | 2,175 |

12 Appropriation of $4 million for HIH Royal Commission was not fully drawn down in 2001/02 with $2.5 million not being required. In 2002/03, the amount of $2.5 million was re-issued for ongoing expenses in relation to the implementation of the recommendations of the Royal Commission. Of this amount $500,000 was drawn down and recognised as appropriation revenue and the balance of $2 million was accounted for as unearned appropriation revenue.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2003

## Note 11. Equity

| | Contributed | | Asset equity reserve | | Accumulated revaluation | | Total equity results | |
|---|---|---|---|---|---|---|---|---|
| | 2003 $'000 | 2002 $'000 | 2003 $'000 | 2002 $'000 | 2003 $'000 | 2002 $'000 | 2003 $'000 | 2002 $'000 |
| **Balance 1 July** | **5,255** | 5,255 | **483** | 558 | **3,517** | 552 | **9,255** | 6,365 |
| Net surplus/(deficit) | **–** | – | | – | **(168)** | 2,965 | **(168)** | 2,965 |
| Transfer to reserves | **–** | – | **4** | (75) | **–** | | **4** | (75) |
| **Balance 30 June** | **5,255** | 5,255 | **487** | 483 | **3,349** | 3,517 | **9,091** | 9,255 |

## Note 12. Cash flow reconciliation

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Note 12A. Reconciliation of operating surplus to net cash from operating activities:** | | |
| Operating surplus/(deficit) before extraordinary items | **(168)** | 2,965 |
| **Non-cash items** | | |
| Depreciation and amortisation of infrastructure, plant and equipment | **1,642** | 1,497 |
| Amortisation of intangibles | **1,847** | 1,333 |
| Intangibles written-off | **–** | 1,602 |
| Infrastructure, plant and equipment revaluation decrement | **4** | – |
| Loss on disposal of infrastructure, plant and equipment | **183** | 108 |
| **Changes in assets and liabilities** | | |
| (Increase)/decrease in receivables | **(3,103)** | (8) |
| (Increase)/decrease in other non-financial assets | **36** | 797 |
| Increase/(decrease) in revenue in advance | **1,024** | 925 |
| Increase/(decrease) in leases | **–** | (24) |
| Increase/(decrease) in employees liabilities | **1,817** | 353 |
| Increase/(decrease) in suppliers liabilities | **54** | (2,190) |
| Increase/(decrease) in other provisions and payables | **(177)** | (575) |
| **Net cash from operating activities** | **3,159** | 6,783 |
| **Note 12B. Reconciliation of cash** | | |
| Cash balance comprises: | | |
| Cash on hand | **10,809** | 10,408 |
| Deposits at call | **6** | 8 |
| **Total cash** | **10,815** | 10,416 |
| **Balance of cash as at 30 June shown in the Statement of Cash Flows** | **10,815** | 10,416 |

## Note 13. Remuneration of Board Members

| | 2003 $ | 2002 $ |
|---|---|---|
| Aggregate amount of superannuation payments in connection with the retirement of Board Members | **36,117** | 31,929 |
| Other remuneration received or due and receivable by Board Members | **703,814** | 730,146 |
| **Total remuneration received or due and receivable by Board Members** | **739,931** | 762,075 |

The number of Board Members of APRA included in these figures are shown below in the relevant remuneration bands:

| | Number | Number |
|---|---|---|
| $nil – $10,000 | **3** | 3 |
| $30,001 – $40,000 | **–** | 1 |
| $40,001 – $50,000 | **3** | 3 |
| $50,001 – $60,000 | **1** | – |
| $120,001 – $130,000 | **1** | 1 |
| $430,001 – $440,000 | **1** | – |
| $470,001 – $480,000 | **–** | 1 |
| **Total** | **9** | 9 |

Total remuneration for each Board Member includes, where applicable, changes in accumulated recreation and long service leave valued in accordance with Commonwealth policy guidelines. As a result, reported remuneration will increase where leave taken is less than the leave entitlements accrued during the year.

## Note 14. Related party disclosures

**Board Members of APRA**

The Board Members of APRA during the year were:

Dr Jeffrey Carmichael (Chair)
Mr Rod Atfield
Professor Berna Collier
Dr David Knox
Dr John Laker
Mr Ian Macfarlane
Mr Donald Mercer
Mrs Marian Micalizzi
Mr Graeme Thompson (Chief Executive Officer)

Board Members of APRA were determined in accordance with section 19 of the Australian Prudential Regulation Authority Act 1998. The Treasurer of the Commonwealth had the power to appoint ordinary members to the Board. The aggregate remuneration of Board Members is disclosed in Note 13 – remuneration of Board Members.

All Board appointments were terminated as at 30 June 2003 following passage of the *Australian Prudential Regulation Authority Amendment Act 2003*. The Board was replaced by a three person Executive Group, whose appointments took effect on 1 July 2003.

## Note14. Related party disclosures (continued)

**Transactions with Board Member-related entities**

There were transactions between APRA and the following Board Member-related entities: the Reserve Bank of Australia; PricewaterhouseCoopers and the Australian Securities and Investments Commission.

The total value of payments and amounts payable to the Reserve Bank of Australia was $91,399 (2002: $72,726) and related to banking services. The total value of receipts and amounts receivable from the Reserve Bank of Australia was $848,261 (2002: $513,143) and arose mainly in its capacity as banker to APRA.

The total value of payments and amounts payable to PricewaterhouseCoopers was $206,983 (2002: $nil) and related mainly to the provision of consulting services. The total value of receipts and amounts receivable from PricewaterhouseCoopers was $nil (2002: $nil).

The total value of payments and amounts payable to the Australian Securities and Investments Commission was $36,934 (2002: $116,918) and related mainly to a staff secondment. The total value of receipts and amounts receivable from the Australian Securities and Investments Commission was $11,636 (2002: $nil) and was related to conduct of a joint seminar.



| | 2003 $ | 2002 $ |
|---|---|---|

## Note 15. Remuneration of officers

| | 2003 $ | 2002 $ |
|---|---|---|
| The aggregate amount of total remuneration of officers shown is: | **9,333,742** | 7,709,790 |

The number of officers included in these figures is shown below in the relevant income bands:

| | Number | Number |
|---|---|---|
| $110,001 – $120,000 | **1** | 5 |
| $120,001 – $130,000 | **3** | 3 |
| $130,001 – $140,000 | **4** | 6 |
| $140,001 – $150,000 | **8** | 8 |
| $150,001 – $160,000 | **6** | 3 |
| $160,001 – $170,000 | **8** | 2 |
| $170,001 – $180,000 | **5** | 4 |
| $180,001 – $190,000 | **1** | 3 |
| $190,001 – $200,000 | **5** | 3 |
| $200,001 – $210,000 | **5** | 2 |
| $210,001 – $220,000 | **1** | 1 |
| $220,001 – $230,000 | **3** | – |
| $240,001 – $250,000 | **–** | 1 |
| $280,001 – $290,000 | **1** | – |
| $300,001 – $310,000 | **–** | 3 |
| $320,001 – $330,000 | **2** | – |
| $350,001 – $360,000 | **–** | 1 |
| | **53** | 45 |

| | | |
|---|---|---|
| The aggregate amount of separation and redundancy/termination benefit payments during the year to officers shown above: | **66,273** | – |

The remuneration of officers' table includes all officers concerned with or taking part in the management of APRA during 2002/03, whose total remuneration exceeded $100,000, except the Chief Executive Officer. Details in relation to the Chief Executive Officer have been incorporated into Note 13 – remuneration of Board Members.

## Note 16. Remuneration of auditors

| | | |
|---|---|---|
| Remuneration to Australian National Audit Office for auditing the financial statements for the reporting period (exclusive of GST) | **73,514** | 68,500 |

The Australian National Audit Office provided no other services during the reporting period.

## Note 17. Average staffing levels

| | Number | Number |
|---|---|---|
| The average number of employees for the Authority during the year was: | **457** | 407 |

## Note 18. Financial instruments

### Note 18A. Terms, conditions and accounting policies

| Financial instrument | Note | Accounting policies and methods (including recognition criteria and measurement basis) | Nature of underlying instrument (including significant terms and conditions affecting the amount, timing and certainty of cash flows) |
|---|---|---|---|
| **Financial assets** | | Financial assets are recognised when control over future economic benefits is established and the amount of the benefit can be reliably measured. | |
| Cash at bank and deposits at call | 7A | Deposits are recognised at their nominal amounts. Interest is credited to revenue as it accrues. | Surplus funds are temporarily placed in the operating bank account with APRA's banker. Interest is earned on the daily balance at the prevailing daily rate and is paid on the first day of the following month. |
| Commonwealth and State Government securities | 7A | Commonwealth and State Government securities are recognised at amortised cost (i.e. at original cost adjusted for amortisation to date of any discount or premium when originally issued). Interest is credited to revenue as it accrues. | APRA invests in securities with terms of up to 90 days. They are guaranteed by the issuing government and are traded in active markets. Effective interest rates averaged 4.75 % (2001/02: 4.21%). Interest is paid on maturity. |
| Receivables for goods and services | 7B | Receivables 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 collection of the debt is judged to be less rather than more likely. | Credit terms for receivables are net 30 days (2001/02: 30 days). |
| Receivables for insurance recoveries and other revenue | 7B | Receivables are recognised at the nominal amounts claimed from Comcover less any amounts expected to be uncollectible. | Credit terms for receivables are net 30 days (2001/02: 30 days). |
| **Financial liabilities** | | Financial liabilities are recognised when a present obligation to another party is entered into and the amount of the liability can be reliably measured. | |
| Revenue in advance | 9C | Where revenue is received in advance of the service being provided the balance relating to work yet to be completed is recognised as revenue in advance. | APRA will recognise the revenue in advance, as revenue as the related work is completed. |
| Provisions | 10B | Lease incentives are recognised as a liability on receipt of the incentives. The amount of the liability is reduced on a straight-line basis over the life of the lease by allocating lease payments between rental expense and reduction of the liability. | APRA received rent-free periods and cash lease incentives in August 1998, February 1999 and February 2001. On 1 July 1998, APRA assumed the lease incentive liabilities of the Insurance and Superannuation Commission. |
| Trade creditors | 9A | 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). | Settlement is usually made net 30 days. |

### Note 18B. Interest rate risk

| Financial instrument | Note | Floating interest rate 2003 $'000 | Floating interest rate 2002 $'000 | Fixed interest rate 1 year or less 2003 $'000 | Fixed interest rate 1 year or less 2002 $'000 | Fixed interest rate 1 to 2 years 2003 $'000 | Fixed interest rate 1 to 2 years 2002 $'000 | Fixed interest rate 2 to 5 years 2003 $'000 | Fixed interest rate 2 to 5 years 2002 $'000 | Non-interest bearing 2003 $'000 | Non-interest bearing 2002 $'000 | Total 2003 $'000 | Total 2002 $'000 | Weighted average effective interest rate 2003 % | Weighted average effective interest rate 2002 % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Financial assets (recognised) | | | | | | | | | | | | | | | |
| Cash at bank and deposits at call | 7A | **10,812** | 10,413 | **–** | – | **–** | – | **–** | – | **–** | – | **10,812** | 10,413 | **4.40** | 4.40 |
| Cash on hand | 7A | **–** | – | **–** | – | **–** | – | **–** | – | **3** | 3 | **3** | 3 | **n/a** | n/a |
| Commonwealth and State Government securities | 7A | **–** | – | **–** | – | **–** | – | **–** | – | – | – | **–** | – | – | – |
| Receivables | 7B | **–** | – | **–** | – | **–** | – | **–** | – | **5,162** | 2,059 | **5,162** | 2,059 | **n/a** | n/a |
| Total financial assets (recognised) | | **10,812** | 10,413 | **–** | – | **–** | – | **–** | – | **5,165** | 2,062 | **15,977** | 12,475 | | |
| Total assets | | | | | | | | | | | | **28,353** | 25,779 | | |
| **Financial liabilities (recognised)** | | | | | | | | | | | | | | | |
| Revenue in advance | 9B | **–** | – | **–** | – | **–** | – | **–** | – | **2,000** | 976 | **2,000** | 976 | **n/a** | n/a |
| Provisions | 10B | **–** | – | **–** | – | **–** | – | **–** | – | **1,998** | 1,596 | **1,998** | 1,596 | **n/a** | n/a |
| Suppliers and other payables | 9A,B | **–** | – | **–** | – | **–** | – | **–** | – | **2,984** | 2,930 | **2,984** | 2,930 | **n/a** | n/a |
| Total financial liabilities (recognised) | | **–** | – | **–** | – | **–** | – | **–** | – | **6,982** | 5,502 | **6,982** | 5,502 | | |
| Total liabilities | | | | | | | | | | | | 19,262 | 16,544 | | |

## Note 18. Financial instruments (continued)

### Note 18C. Net fair values of financial assets and liabilities

| | Note | Total carrying amount 2003 $'000 | 2002 $'000 | Aggregate net fair value 2003 $'000 | 2002 $'000 |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash at bank and deposits at call | 7A | **10,812** | 10,405 | **10,812** | 10,405 |
| Cash on hand | 7A | **3** | 3 | **3** | 3 |
| Commonwealth and State Government securities | 7A | **–** | 8 | – | 8 |
| Receivables | 7B | **5,162** | 2,059 | **5,162** | 2,059 |
| **Total financial assets** | | **15,977** | 12,475 | **15,977** | 12,475 |
| **Financial liabilities (recognised)** | | | | | |
| Revenue in advance | 9B | **2,000** | 976 | **2,000** | 976 |
| Provisions | 10B | **1,998** | 1,596 | **1,998** | 1,596 |
| Suppliers | 9A,B | **2,984** | 2,930 | **2,984** | 2,930 |
| **Total financial liabilities (recognised)** | | **6,982** | 5,502 | **6,982** | 5,502 |

**Financial assets**

The net fair values of cash, government securities and non–interest-bearing monetary financial assets approximate their carrying amounts.

**Financial liabilities**

The net fair values for suppliers and revenue in advance are approximated by their carrying amounts.

### Note 18D. Credit risk exposures

APRA's maximum exposures 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 *Statement of Financial Position*.

APRA's highest credit risk exposure is levies of $221,191 (2002: $810,558), which were receivable at 30 June 2003 from superannuation funds regulated by APRA. The asset has been recognised in the *Statement of Financial Position*, net of a provision for doubtful debts.

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



## Note 19. Administered items

### Note 19A. Revenues administered on behalf of Government for the year ended 30 June 2003

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Revenues** | | |
| **Taxation** | | |
| Financial institutions supervisory levies current and prior years [13] | **50,352** | 69,337 |
| Financial institutions supervisory levies prior year adjustment | **900** | – |
| Financial institutions supervisory levies future year | **28,192** | 23,481 |
| Total taxation | **79,444** | 92,818 |
| **Non-Taxation** | | |
| Refunds by APRA of overpayments by institutions[14] | **–** | 766 |
| **Total revenues administered on behalf of Government** | **79,444** | 93,584 |

Future year levies paid by 30 June are recognised in the year of receipt as the Commonwealth has control of the asset (cash) as at 30 June, and it is highly unlikely that any part of the money would be claimed by industry as at that date.

### Note 19B. Expenses administered on behalf of Government for the year ended 30 June 2003

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Expenses** | | |
| **Net write-down of assets** | | |
| Levies waived (see Note 4F)[15] | **257** | 552 |
| Levies written-off (see Note 4G) | **122** | 321 |
| **Total write-down of assets** | **379** | 873 |
| **Total expenses administered on behalf of Government** | **379** | 873 |

13 Notes 4B to 4E provide details by industry of levy revenue for the current and prior years (including current year amounts paid in the previous year).

14 Up until 2001/02, APRA refunded any over-payments from financial institutions directly to the institution from its operating account. APRA was therefore meeting an obligation of the Commonwealth and an administered revenue resulted. From 2002/03, APRA refunds these amounts directly from the Official Public Account and there is no longer has any impact on revenue.

15 The number of levies and late payment penalties waived in 2003 was 139 (2002: 1,401)

## Note 19. Administered items (continued)

### Note 19C. Assets administered on behalf of Government as at 30 June 2003

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Financial assets** | | |
| **Cash** | | |
| Cash at bank [16] | **1,930** | – |
| **Receivables** | | |
| Superannuation levies | **221** | 811 |
| Less: Provision for doubtful debts | **(12)** | (74) |
| Net receivables | **209** | 737 |
| **Accrued revenue** | | |
| Accrued levy revenue | **20** | 78 |
| Total accrued revenues | **20** | 78 |
| **Total financial assets** | **2,159** | 815 |
| **Total assets administered on behalf of Government** | **2,159** | 815 |
| **Receivables which are overdue are aged as follows:** | | |
| Not overdue | **167** | 622 |
| Overdue by: | | |
| – less than 30 days | **18** | 108 |
| – 30 to 60 days | **2** | 2 |
| – 60 to 90 days | **34** | 3 |
| – more than 90 days | **–** | 76 |
| **Total levies receivable** | **221** | 811 |
| **The provision for doubtful debts is aged as follows:** | | |
| Not overdue | **–** | – |
| Overdue by: | | |
| – less than 30 days | **–** | – |
| – 30 to 60 days | **–** | (2) |
| – 60 to 90 days | **(1)** | (3) |
| – more than 90 days | **(11)** | (67) |
| **Total provision for doubtful debts** | **(12)** | (74) |
| **Total receivables (net)** | **209** | 737 |

16 Supervisory levies payments received through Australia Post were recorded in the ledger on 30 June 2003, but not deposited to the bank account until 1 July, 2003.



### Note 19D. Administered reconciliation table

| | 2003 $'000 | 2002 $'000 |
|---|---|---|
| **Opening administered assets less administered liabilities at 1 July 2002** | **815** | (3,662) |
| Plus administered revenues | **79,444** | 93,584 |
| Adjustment to prior year revenue | **(900)** | 900 |
| Less administered expenses | **(379)** | (873) |
| Plus transfers from Official Public Account for refunds | **231** | – |
| Plus correction to prior year reconciliation | **–** | 32 |
| Less transfers to Official Public Account | **(77,052)** | (89,166) |
| **Closing administered assets less administered liabilities** | **2,159** | 815 |

### Note 19E. Administered commitments

There were no administered commitments for 2002/03 (2001/02: $nil)

### Note 19F. Administered contingencies

There were no administered contingencies for 2002/03 (2001/02: $nil)

## Note 19. Administered items (continued)

### Note 19H. Administered financial instruments

(a) Terms, conditions and accounting policies

| Financial instrument | Note | Accounting policies and methods (including recognition criteria and measurement basis) | Nature of underlying instrument (including significant terms and conditions affecting the amount, timing and certainty of cash flows) |
|---|---|---|---|
| Financial assets | 19C | Financial assets are recognised when control over future economic benefits is established and the amount of the benefit can be reliably measured. | |
| Receivables for levies | 19C | Receivables 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 collection of the debt is judged to be less rather than more likely. | Credit terms for levies comply with the due date for payment of levies, as specified under the *Financial Institutions Supervisory Levies Collection Act 1998*. For non-superannuation entities the due date for payment is 1 July of the financial year, or within six weeks of becoming a regulated entity. For superannuation entities, the due date for payment is within six weeks of lodgement of an annual return, or within six weeks of becoming a regulated entity.<br>The levies will be invoiced with a due date for payment consistent with the legislation as detailed above. |
| Accrued revenues | | Accrued revenues are recognised at the nominal amounts as they accrue. The amount recognised relates to superannuation returns which have been lodged but for which the related levies have not been invoiced as at the end of the financial year. | |

### Note 19H. Administered financial instruments (continued)

(b) Interest rate risk

| Financial instrument | Note | Non-interest bearing 2003 $'000 | Non-interest bearing 2002 $'000 | Total 2003 $'000 | Total 2002 $'000 |
|---|---|---|---|---|---|
| **Financial assets (recognised)** | | | | | |
| Cash | 19C | **1,930** | – | **1,930** | – |
| Receivables | 19C | **209** | 737 | **209** | 737 |
| Accrued revenue | 19C | **20** | 78 | **20** | 78 |
| **Total financial assets (recognised)** | | **2,159** | 815 | **2,159** | 815 |
| **Total assets** | | **2,159** | 815 | **2,159** | 815 |

(c) Net fair values of financial assets

| | Note | Total carrying amount 2003 $'000 | Total carrying amount 2002 $'000 | Aggregate net fair value 2003 $'000 | Aggregate net fair value 2002 $'000 |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash | 19C | **1,930** | – | **1,930** | – |
| Receivables | 19C | **209** | 737 | **209** | 737 |
| Accrued revenue | 19C | **20** | 78 | **20** | 78 |
| **Total financial assets** | | **2,159** | 815 | **2,159** | 815 |

**Financial assets**

The net fair values of financial assets approximate their carrying amounts.

(d) Credit risk exposures

The Commonwealth's maximum exposures 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 Note 19C.

The Commonwealth's highest credit risk exposure is levies of $221,191 (2002: $810,558) receivable at 30 June 2003 from superannuation funds regulated by APRA. The asset has been recognised in Note 19C - net of a provision for doubtful debts.

## Note 20. Appropriations

The table in Note 20A and Table 1 in Note 20B 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. Table 2 in Note 20B relates to a special appropriation, which is administered on behalf of the Government.

### Note 20A. Cash basis acquittal of appropriations from Appropriation Acts 1 and 3

| | Departmental outputs | | Total | |
|---|---|---|---|---|
| | 2003 $'000 | 2002 $'000 | 2003 $'000 | 2002 $'000 |
| Balance brought forward from previous year | – | – | – | – |
| Re-issue of appropriation from previous year | **2,500** | – | **2,500** | – |
| Appropriation for reporting year | – | 6,100 | – | 6,100 |
| Refunds credited (FMA Acts 30) | – | (2,500) | – | (2,500) |
| Available for payment from CRF | **2,500** | 3,600 | **2,500** | 3,600 |
| Payments made out of CRF | **(500)** | 3,600 | **(500)** | (3,600) |
| **Balance carried forward to next year** | **2,000** | – | **2,000** | – |
| Represented by: | | | | |
| Appropriations receivable: | **2,000** | – | **2,000** | – |

### Note 20B. Cash basis acquittal of appropriations from special appropriations

**Table 1. Special appropriation (limited amount)**

| | Departmental outputs | | Total | |
|---|---|---|---|---|
| | 2003 $'000 | 2002 $'000 | 2003 $'000 | 2002 $'000 |
| *Australian Prudential Regulation Authority Act 1998* – section 50 | | | | |
| Purpose: Funding of APRA | | | | |
| Balance brought forward from previous year | **815** | 1,018 | **815** | 1,018 |
| Appropriation for reporting year | **59,686** | 54,562 | **59,686** | 54,562 |
| Available for payment from CRF | **60,501** | 55,580 | **60,501** | 55,580 |
| Payments made out of CRF | **(59,375)** | (54,765) | **(59,375)** | (54,765) |
| **Balance carried forward to next year** | **1,126** | 815 | **1,126** | 815 |
| Represented by: | | | | |
| Appropriations receivable | **1,126** | 815 | **1,126** | 815 |

**Table 2. Special appropriations (unlimited amount)**

| | Administered | | Total | |
|---|---|---|---|---|
| | 2003 $'000 | 2002 $'000 | 2003 $'000 | 2002 $'000 |
| Payments made out of CRF | **(232)** | – | **(232)** | – |

## Note 21. Assets held in trust

**Other Trust Moneys Account**

An amount of $6,250 held in the Reserved Money Fund – Other Trust Moneys as untraceable moneys, was transferred to the Official Public Account at APRA's request by the Department of Finance and Administration, in June 2002. Subsequent advice indicates that these funds may still be officially the responsibility of APRA until such time as the account is formally closed by order of the Minister for Finance.

**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 2003 is nil.

## Note 22. Special account

**Superannuation Protection Account**

This account was established under section 234 of the *Superannuation Industry (Supervision) Act 1993* to facilitate the recovery of financial assistance provided to superannuation fund members suffering adverse outcomes resulting from fraud and misappropriation by fund trustees. The account has not been used to 30 June 2003 and had a nil balance at that date. However, with the gazettal of the *Superannuation (Financial Assistance Funding) Levy Regulations 2003* on 30 June 2003, a process of imposition and collection of a Financial Assistance Levy in 2003/04 was commenced. Further levies are anticipated in future years.

## Note 23. Reporting of outcomes

### Note 23A. 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, 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 programs; and prudential advice.

## Note 23. Reporting of outcomes (continued)

### Note 23B. Net cost of outcome delivery

| | Outcome 1 2003 $'000 | 2002 $'000 |
|---|---|---|
| Administered expenses | **379** | 873 |
| Departmental (Authority) expenses | **68,624** | 59,231 |
| **Total Expenses** | **69,003** | 60,104 |
| Costs recovered from provision of goods and services to the non-government sector | | |
| Administered | **–** | – |
| Departmental (Authority) | **1,758** | 959 |
| Total costs recovered | **1,758** | 959 |
| Other external revenues | | |
| Administered | | |
| Financial institutions supervisory levies | **79,433** | 93,584 |
| Total Administered | **79,433** | 93,584 |
| **Departmental (Authority)** | | |
| Sale of goods and services – to related entities | **1,148** | 372 |
| Interest | **1,114** | 1,033 |
| Revenue from sale of assets | **1** | – |
| Insurance recoveries and other revenue | **3,283** | 2,636 |
| **Total departmental (Authority)** | **5,546** | 4,041 |
| **Total other external revenues** | **84,979** | 97,625 |
| **Total revenues** | **86,737** | 98,584 |
| **Net cost/(contribution) of outcome** | **(17,734)** | (38,480) |

The output reporting is derived from the APRA internal activity system, which captures the time spent by each employee on the three published outputs v. policy development, surveillance programs 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.



### Note 23C. Departmental (Authority) revenues and expenses by output groups and outputs

| | Output 1.1.1 policy development | | Output 1.1.2 surveillance programs | | Output 1.1.3 prudential advice | | Total | |
|---|---|---|---|---|---|---|---|---|
| | 2003 $'000 | 2002 $'000 | 2003 $'000 | 2002 $'000 | 2003 $'000 | 2002 $'000 | 2003 $'000 | 2002 $'000 |
| **Authority operating expenses** | | | | | | | | |
| Employees | **6,141** | 5,166 | **29,654** | 27,009 | **5,156** | 2,218 | **40,951** | 34,393 |
| Suppliers – normal operations | **3,683** | 2,259 | **13,947** | 16,101 | **2,675** | 748 | **20,305** | 19,108 |
| Suppliers – HIH Royal Commission expenses[17] | **–** | – | **–** | – | **3,690** | 2,899 | **3,690** | 2,899 |
| Depreciation and amortisation | **392** | 463 | **2,813** | 2,071 | **284** | 297 | **3,489** | 2,831 |
| Write-off of assets and value of assets sold | **28** | – | **137** | – | **24** | – | **189** | – |
| **Total Authority operating expenses** | **10,244** | 7,888 | **46,551** | 45,181 | **11,829** | 6,162 | **68,624** | 59,231 |
| **Funded by:** | | | | | | | | |
| Revenues from Government | **6,595** | 6,607 | **46,186** | 47,096 | **8,371** | 3,493 | **61,151** | 57,196 |
| Sale of goods and services – fees | **133** | 42 | **928** | 296 | **168** | 18 | **1,228** | 356 |
| Sale of goods and services – rent and other | **181** | 114 | **1,267** | 810 | **230** | 51 | **1,678** | 975 |
| Interest | **120** | 120 | **841** | 859 | **152** | 54 | **1,114** | 1,033 |
| Proceeds from disposal of assets | **–** | – | **1** | – | **–** | – | **1** | – |
| Insurance recoveries and other revenue | **–** | – | **–** | – | **3,284** | 2,636 | **3,284** | 2,636 |
| **Total Authority revenues** | **7,029** | 6,883 | **49,223** | 49,061 | **12,205** | 6,252 | **68,456** | 62,196 |

17 Other expenses directly related to APRA's involvement in the HIH Royal Commission and implementation of certain recommendations of the Royal Commission are not reported separately as suppliers expenses under Output 1.1.3. Such costs, in the order of $780,000 (2002: $372,000) are instead reported as part of employees expenses under Output 1.1.3. Note 23D – administered revenues and expenses by outcome.

## Note 23. Reporting of outcomes (continued)

### Note 23D. Administered revenues and expenses by outcome

| | Outcome 1 | |
|---|---|---|
| | **2003 $'000** | 2002 $'000 |
| **Operating revenues** | | |
| Financial institution supervisory levies | **78,532** | 92,818 |
| Refunds by APRA | **–** | 766 |
| **Total operating revenues** | **78,532** | 93,584 |
| **Operating expenses** | | |
| Levies waived | **257** | 552 |
| Levies written–off | **122** | 321 |
| **Total operating expenses** | **379** | 873 |

The Authority's outcome is described at Note 23A.



Australian National Audit Office

**INDEPENDENT AUDIT REPORT**

**To the Minister for Revenue and Assistant Treasurer**

**Scope**

I have audited the financial statements of the Australian Prudential Regulation Authority for the year ended 30 June 2003. The financial statements comprise:

- Statement by APRA Members;
- Statements of Financial Performance, Financial Position and Cash Flows;
- Schedules of Commitments, Contingencies and Administered Items; and
- Notes to and forming part of the Financial Statements.

APRA members are responsible for the preparation and presentation of the financial statements and the information they contain. I have conducted an independent audit of the financial statements in order to express an opinion on them to you.

The audit has been conducted in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards, to provide reasonable assurance as to whether the financial statements are free of material misstatement. Audit procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial statements and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether, in all material respects, the financial statements are presented fairly in accordance with Accounting Standards and other mandatory professional reporting requirements in Australia and statutory requirements so as to present a view which is consistent with my understanding of the Authority's financial position, its financial performance and its cash flows.

The audit opinion expressed in this report has been formed on the above basis.

**Audit Opinion**

In my opinion the financial statements:

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

(ii) give a true and fair view, in accordance with applicable Accounting Standards and other mandatory professional reporting requirements in Australia and the Finance Minister's Orders, of the financial position of the Australian Prudential Regulation Authority as at 30 June 2003, and its financial performance and cash flows for the year then ended.

Australian National Audit Office

Paul Hinchey
Senior Director

Delegate of the Auditor-General

Sydney
19 September 2003

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

# 9 Statutory report

## Statutory reporting requirements index

APRA has reported in accordance with the following Commonwealth legislation:

- *Australian Prudential Regulation Authority Act 1998* (APRA Act);
- *Commonwealth Authorities and Companies Act 1997* (CAC Act);
- *Environmental Protection and Biodiversity Conservation Act 1999;*
- *Equal Employment Opportunity (Commonwealth Authorities) Act 1987* (EEO Act);
- *Freedom of Information Act 1992* (FOI Act);
- *Occupational Health and Safety (Commonwealth Employment) Act 1991* (OHS Act);
- Commonwealth Fraud Control Guidelines and the Department of the Prime Minister and Cabinet Guidelines.

Changes flowing from amendments to the APRA Act, which took effect from 1 July 2003, have been identified throughout the *Statutory report*.

## 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* 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 2002/2003. There were no continuing appointments during the year.

APRA did not exercise its powers under Part 15 of the *Retirement Savings Accounts Act 1997* during the year. It exercised its powers under Part 29 of the SIS Act as set out below:

| Exemption number | Date | Provision of SIS regulations exempted |
|---|---|---|
| 127 | 4/12/02 | Regulation 6.29 |
| 128 | 3/02/03 | Regulation 6.22 |
| 129 | 7/02/03 | Paragraph 9.29(a) |

## Commonwealth Authorities and Companies Act 1997

### Auditor-General's activities

The Australian National Audit Office (ANAO) tabled its performance audit of APRA's prudential supervision of superannuation funds in September 2003.

APRA has accepted the ANAO's recommendations and is drawing up action plans to meet these recommendations.

In addition, see page 89 of the *Financial statements* in this Report.

### Board Members' attendance

See page 43 of the *Corporate governance* section of this Report.

### Board Members' qualifications

See pages 41-42 of the *Corporate governance* section of this Report.

### Board Members' statement

See page 47 of *Financial statements* in this Report.

### Courts and tribunals

Significant developments in external scrutiny of APRA, including judicial decisions or comments, or decisions or comments made by an administrative tribunal that had, or may have, a significant effect on APRA's operations, are covered in *From the Chairman* section of this Report.

APRA's *Supervisory approach* section of this Report contains details of court decisions relating to enforcement action taken by APRA.

## 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 or retirement income standards, and (from 1 July 2003) 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.

## Financial statements

See page 47 of *Financial statements* in this Report.

## Indemnities and insurance premiums

The APRA Board entered indemnities with Board members and, as required, officers consistent with, and to the extent allowed by, section 27M of the CAC Act. APRA has entered into similar agreements with APRA members.

APRA directors 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 internet site: *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 the inside back cover of this Report.

## Organisation chart

See page 102 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.

APRA officers made themselves available for public hearings before:

- the Senate Economics Legislation Committee (sitting as Senate Estimates);
- the Parliamentary Joint Committee on Corporations and Financial Services: Reference on Banking and Financial Services in Rural, Regional and Remote Areas of Australia;
- the Senate Select Committee on Superannuation: Reference on Planning for Retirement;
- the Senate Select Committee on Superannuation: Reference on Superannuation (Financial Assistance Funding) Amendment Bill and Related Bills;
- the Senate Economics References Committee: Reference on Public Liability and Professional Indemnity Insurance;
- the Senate Select Committee on Superannuation: Reference on Superannuation and Standards of Living in Retirement; and
- the Senate Economics Legislation Committee: Reference on Financial Sector Legislation Amendment Bill (No 2).

An informal briefing was held between members of the House of Representatives Standing Committee on Economics, Finance and Public Administration and APRA management in April 2003.

In addition to written submissions made to some of these committees, APRA also provided a written submission to the Joint Standing Committee on the National Capital and External Territories. This related to the establishment of credit facilities in the Indian Ocean Territories.

## Privacy Commission

There were no investigations by the Privacy Commissioner under section 36 of the *Privacy Act 1988* during 2002/03. No reports were served under section 30 of the Act. The Privacy Commission 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 Commission in respect of APRA's operations.

Privacy inquiries relating to APRA should be addressed to:

The Privacy Officer
Office of General Counsel
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 Senator the Hon Helen Coonan, Minister for Revenue and Assistant Treasurer.

## Review of operations and prospects

See the narrative section of this Report, beginning on page 2.

## Risk Management and Audit Committee attendance

See page 43 of the *Corporate governance* section of this Report.

## Statement on Governance

See the *Corporate governance* section of this Report.

EEO STAFF DATA STAFF DIVERSITY AS AT 30 JUNE 2003

| Level | Female | Male | ATSI | NESB1 | NESB2 | PWD |
|---|---|---|---|---|---|---|
| Level 1 | 64 | 23 | | 19 | | 1 |
| Level 2 | 60 | 39 | | 26 | 3 | 1 |
| Level 3 | 66 | 101 | | 39 | 3 | 1 |
| Level 4 | 28 | 62 | | 22 | 2 | |
| Senior | 8 | 48 | 1 | 8 | 1 | 1 |
| Executive | 0 | 4 | 0 | 1 | 0 | 0 |
| **Total** | **226** | **227** | **1** | **115** | **9** | **4** |

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

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

### Workplace diversity program report

APRA has taken a proactive and innovative approach in meeting its responsibilities under the EEO Act, by establishing a comprehensive workplace diversity strategy. 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.

The Staff Consultative Group plays a key role in ensuring the implementation and ongoing review of this strategy. Some of the key objectives of this strategy include:

- staff satisfaction with work/life balance is maximised over time;
- career management program is responsive to diversity and maximises development opportunities for all employees; and
- APRA continues to take steps to promote a discrimination and harassment-free workplace and effectively responds to any issues that may arise.

APRA has also established a Women's Steering Committee to increase the level of participation of women in leadership positions in APRA.

This Committee:

- contributes ideas and advice about increasing the level of women in management at APRA;
- identifies priority issues and initiatives for women in APRA; and
- links with other networks and agencies to develop support with and for women at APRA.

## 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 2002/03, APRA received ten applications under the FOI Act and no applications for internal review.

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

| | |
|---|---|
| Granted in full | 4 |
| Granted in part | 1 |
| Access refused | 4 |
| Withdrawn | 1 |
| Transferred to another agency | 0 |
| On hand at 30 June 2001 | 0 |
| Total | 10 |

While charges collected were $277.75, the estimated cost of handling FOI requests in 2002/03 was $2,500.

## 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 Coordinator
Office of General Counsel
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 free of charge from the APRA website. Some publications, however, attract a charge. The website contains applications, regulatory information, prudential statements, circulars and guidelines covering the types of entities that APRA regulates. These may be changed over time with the completion of various projects.

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
AUSTRALIA
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 (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,* and guidance notes;
  - 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 'Insight') and other research material;
  - policy discussion papers;
  - media releases;
  - seminar papers and copies of speeches given on behalf of APRA;
  - 'Points of Presence' (concerning the availability of banking services in rural and regional areas);
  - insurance and superannuation bulletins;
  - corporate information;
  - procedural guidelines;
  - enabling legislation; and
  - indexed file list for the purposes of Senate Continuing Order No. 6.

## Consultative arrangements

In most cases, APRA consults with industry bodies and regulated entities prior to formulating or amending policies or finalising prudential standards.

## Executive and consultative committees from 1 July 2002 to 30 June 2003

### Executive Committee

This Committee comprised the Chief Executive Officer and the Executive General Managers and was responsible for oversight of policy and operational issues throughout APRA.

### Executive Team

The Executive Team met quarterly to review progress in building APRA's business plan, to monitor performance against it and oversee modifications (if any).

### Cross-divisional industry groups

There are four groups which cover the following sectors:

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

Each committee promotes consistent practice and application of existing policy on material issues across the industry. These are issues that set an industry precedent or require clear consistent APRA-wide interpretation of existing policy, but do not include issues leading to new or changed policy.

### Cross-divisional Licensing Committee

The Committee seeks to ensure consistency in licensing practice and application across all APRA-supervised 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 the action which should be taken.

### Information Technology Operating Committee

The Committee's function is to monitor progress of IT projects, recommend prioritisation and allocation of resources for approved projects and review and recommend new projects.

### Knowledge Management Steering Committee

The Committee provides feedback, recommends improvements and provides assistance and guidance on cross-divisional operational issues and performance, and develops and recommends a strategic knowledge management plan that meets APRA's statutory requirements as well as recognised best practice standards.

### Learning and Development Advisory Group

The Group facilitates communication and consultation with staff on the development and implementation of the learning and development strategy.

### Occupational Health and Safety Committee

The Committee 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.

### Policy Steering Committee

The Committee's role is to provide advice to relevant Policy, Research and Consulting Division staff on APRA's preferences for new policy information. It reviews the policy agenda and provides input to the Division's reports to senior management.

### Performance and Reward Reference Group

The Group facilitates communication and consultation with staff on the development and implementation of APRA's performance management and reward system, and contributes ideas that promote a performance culture.

### 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.

### Statistics Steering Group

The Group provides strategic guidance for this significant organisational resource. It sets the priorities for statistics in line with APRA's supervisory and policy needs.

### Research Committee

The Group provides guidance, coordination and support for research activities within APRA, as well as the prioritisation of new research projects. In this capacity it reports to the Executive General Manager – Policy, Research and Consulting Division.

### Women's Steering Committee

See workplace diversity program 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 Commonwealth Operations – Report for 2001–2002', the Department of Industry Science and Resources shows that overall energy consumption per person in APRA offices was 9,832 MJ, which more than meets the target of 10,000 MJ/person. The target for 2002/2003 remains at 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.

## 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 process are in place; and
- annual fraud data has been collected and reported that complies with the 'Commonwealth Fraud Control Guidelines'.

## 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 were given to APRA.

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

Responsibilities imposed by the legislation were identified and allocated to individual staff members. This includes the identification and training of health and safety staff representatives at all work locations.

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

Policy and procedures have been developed with the assistance of an ergonomic consultant to identify, assess and control hazards associated with work processes, particularly computer-based work.

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.

In addition, an audit into APRA's policies, procedures and guidelines was carried out by Comcare (APRA's workers compensation insurer). All recommendations flowing from that audit have been implemented.

### OHS policies including agreement with employees, establishment of committees and selection of health and safety representatives

Arrangements for consultation on all OHS issues were undertaken, including the maintenance of the OHS Committee with four staff representatives and four management representatives.

The OHS committee satisfies all the requirements of the legislation, 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, seventeen incidents were notified to APRA, none of which required a report to Comcare in accordance with section 68 of the OHS Act. The incidents were in the following locations:

| Location | Number |
|---|---|
| On APRA premises | 5 |
| Home to work/work to home | 2 |
| Other | 10 |
| **Total** | **17** |

## Prime Minister and Cabinet Guidelines

### Commonwealth disability strategy

APRA is reviewing its adherence to the Commonwealth's Disability Strategy both as an employer and as a provider, principally of information and, to a more limited extent, services to the public.

APRA continues to ensure that there are no obstacles to those with disabilities contained in its employment practices and procedures and 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.

## 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; selection and evaluation process resulting in fair competition; effective services and value for money; project definition and outcomes; and superannuation implications.

The main purpose for which consultants were engaged were audit services; training; financial and accounting services; IT consultancies; legal advice; litigation services; management consultancy; recruitment selection, administration and outplacement and counselling; and professional services.

The total number of consultants engaged was 137 and the total amount paid was $8.2 million.

## Performance pay

APRA has a performance bonus system, designed in consultation with staff and management and covering all employees. For 2002/03, the aggregate bonus pool was just over $1.9 million. Bonuses were paid early in July 2003.

## Staff statistics

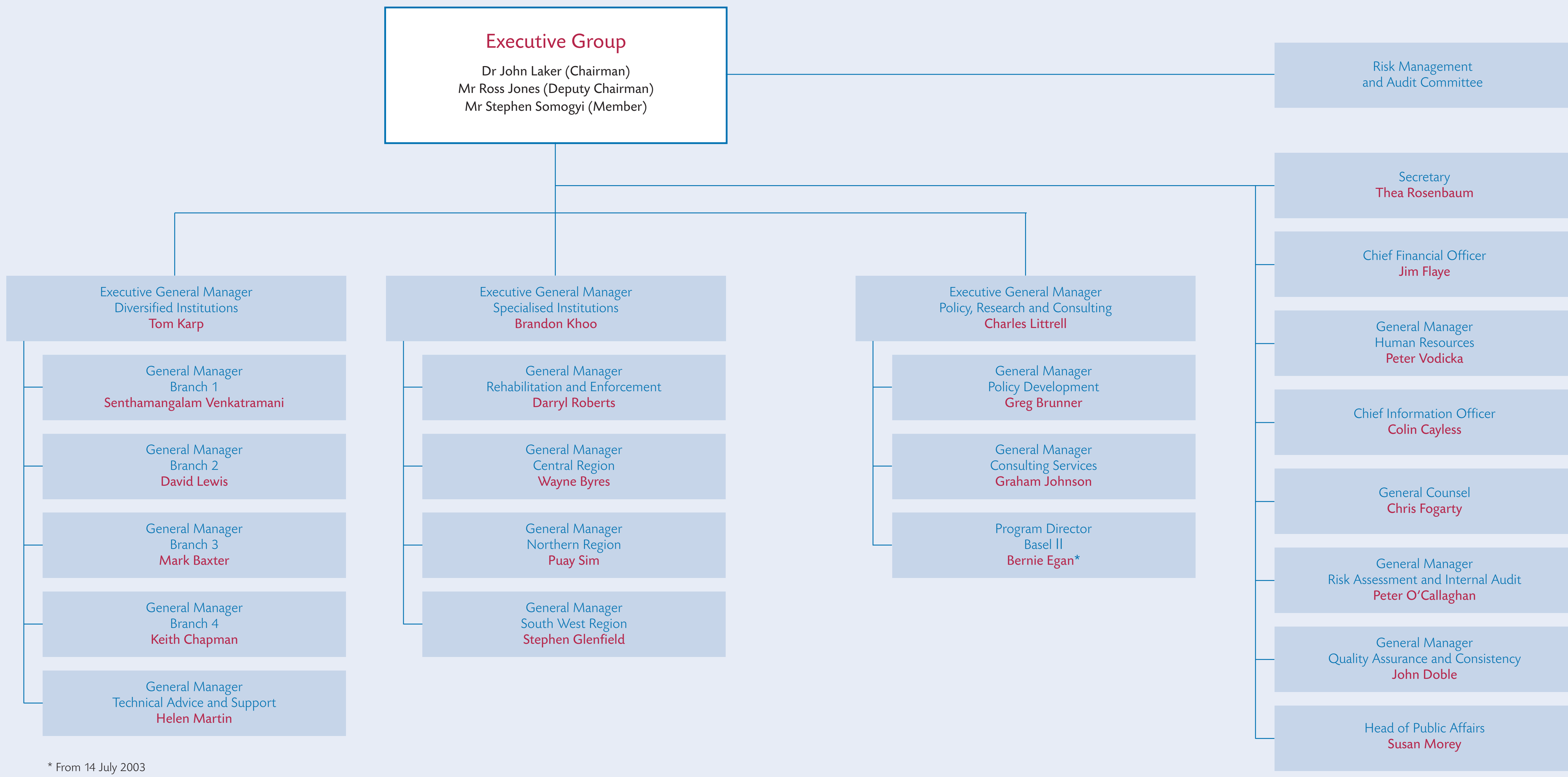
**Staff by location and full-time/part-time as at 30 June 2003**

| Location | Full-time | Part-time | Total |
|---|---|---|---|
| Adelaide | 8 | | 8 |
| Brisbane | 22 | | 22 |
| Canberra | 31 | 23 | 54 |
| Melbourne | 64 | 3 | 67 |
| Perth | 8 | | 8 |
| Sydney | 331 | 13 | 344 |
| **Total** | **464** | **39** | **503** |

**Staff by division and full-time/part-time as at 30 June 2003**

| Division | Full-time | Part-time | Total |
|---|---|---|---|
| Corporate Services | 92 | 3 | 95 |
| Diversified Institutions | 65 | 7 | 72 |
| Policy, Research and Consulting | 108 | 2 | 110 |
| Specialised Institutions | 199 | 27 | 226 |
| **Total** | **464** | **39** | **503** |

# ORGANISATIONAL CHART




* From 14 July 2003

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## OTHER OFFICES

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243–251 Northbourne Avenue
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GPO Box 9836
Canberra ACT 2601

Telephone: 1300 131 060
Facsimile: 02 6213 5307

### Queensland

Level 23
300 Queen Street
Brisbane QLD 4000

GPO Box 9836
Brisbane QLD 4001

Telephone: 07 3001 8500
Facsimile: 07 3001 8501

### South Australia

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100 Pirie Street
Adelaide SA 5000

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Perth WA 6000

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