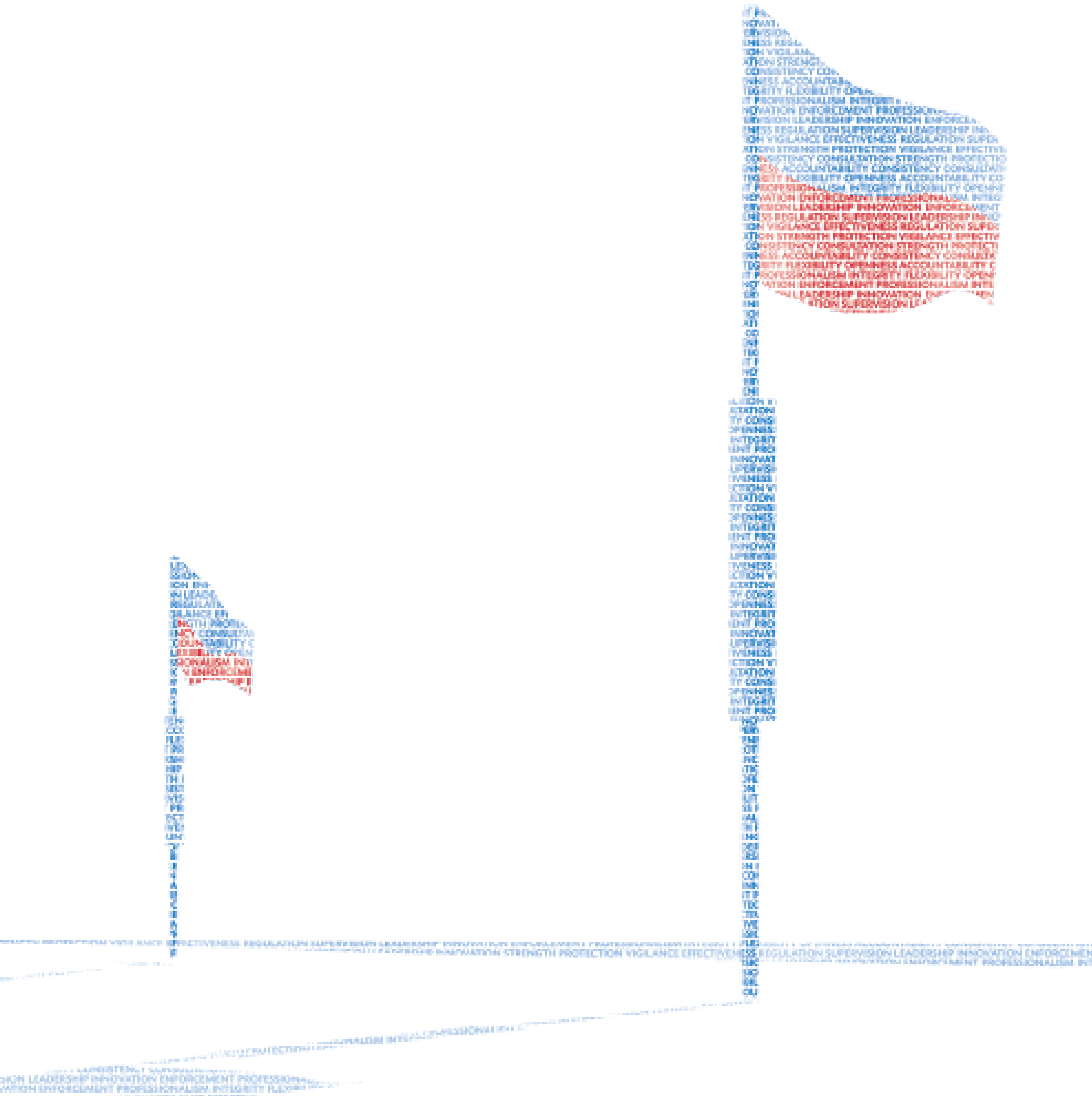
ANNUAL REPORT 2004



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 $2 trillion in assets for 20 million Australian depositors, policyholders and superannuation fund members.

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

Our 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.

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FROM THE CHAIRMAN

The Australian economy continued its strong run in 2003/04. Solid economic growth was accompanied by low inflation and unemployment, confidence levels remained high and over-heating in the housing market began to ease. Globally, a long-awaited recovery in economic activity took root and equity markets, spurred by improving global prospects and a renewed appetite for risk on the part of investors, rallied sharply. The confluence of these positive domestic and global developments assured the continued good health of the Australian financial system and provided a supportive context for APRA's activities as prudential regulator.

The strong growth of housing credit in Australia remained a major focus for APRA over the year. Buoyant conditions in demand for housing finance, notwithstanding rising household debt servicing burdens, can be a temptation for unwise lending decisions. Accordingly, APRA has kept the lending practices of authorised deposit-taking institutions under close scrutiny and, during the year, it completed a searching test of the ability of these institutions to withstand a significant correction in the property market, with reassuring results. Overall, asset quality and capital adequacy in the deposit-taking sector remained strong.


FLEXIBILITY OPENNESS ACCOUNTABILITY CONSISTENCY CONSULTATION STRENGTH PROTECTION VIGILANCE EFFECTIVENESS REGULATION SUPERVISION LEADERSHIP INNOVATION

The rally in equity markets proved a fillip to the insurance and superannuation sectors and helped ease earlier concerns about the damaging effect of sustained low investment returns, particularly for defined benefit superannuation schemes. The momentum of the global equity rally, it must be noted though, has not been maintained. The general insurance industry benefited as well from claims experience that was well within expected bounds and from a more disciplined approach to premium setting, in which short-sighted market share considerations appear to have given way to longer term and sustainable assessments of risk.

A strengthened APRA

APRA's new Executive Group – Ross Jones (Deputy Chairman), Steve Somogyi (APRA Member) and myself – has now completed its first year in office. On our appointment, we gave two commitments to the Australian community: that we would work to restore confidence in APRA as a vigilant, vigorous and effective prudential regulator, and that we would ensure the lessons from the HIH failure are fully absorbed. We believe we have made good strides in these directions over the year, with the support of our very dedicated APRA staff.

The lessons from the HIH failure, drawn out by the HIH Royal Commission, are clear. To be effective, a prudential regulator must operate within a robust supervisory framework and have appropriate powers to intervene, must have effective warning systems of emerging distress in financial institutions, and must have adequate levels of staff with the skill, experience and will to act in the interests of beneficiaries. Pursuing improvements in each of these areas has set the Executive Group's priorities for 2003/04 and beyond.

The supervisory framework

Working closely with the Government, APRA had a very active year in its program to upgrade the supervisory framework in Australia.

A major initiative was the follow-up to the Report of the HIH Royal Commission. The Report identified a number of ways in which the supervisory regime for general insurance introduced in July 2002 – itself a more rigorous and risk-focussed regime than its predecessor – could be strengthened. The Government has responded to the recommendations made and, in turn, APRA has released proposals to enhance its prudential standards, particularly in the areas of corporate governance and disclosure. Our proposals on the structure and composition of boards, the pivotal decision-making body in an institution, have proven controversial. What should not be controversial, however, is the principle that boards of institutions regulated by APRA should perform to the highest standards of prudence. APRA has been consulting widely on how this principle can be met in practical ways.

The Government's reforms to superannuation safety, now in place, have delivered a significant boost to APRA's supervisory capacity in this vital industry. The comprehensive licensing regime and upgrading of prudential requirements will put the supervision of superannuation entities onto a basis more comparable to that of other APRA-regulated institutions. APRA was closely involved in the drafting of the prudential requirements and is now geared-up for the licensing task.

Elsewhere, APRA has been tightening the capital adequacy framework that applies to housing lending and to the provision of lenders mortgage insurance, which assumes a significant proportion of credit risk in housing lending in this country. It has continued to work closely with the Basel Committee on Banking Supervision and with deposit-taking institutions on the new global framework for capital adequacy. The framework has now been finalised but much work lies ahead in implementing it in Australia, on international timetables. The timetable for Australian entities adopting new international accounting standards is much tighter still. APRA has been assessing the readiness of supervised institutions for this significant change and has set its own preparations in train.

During the year, APRA also released for discussion the first of its harmonised prudential standards for the deposit-taking, life and general insurance industries. The proposed standards cover the fitness and propriety of persons in responsible positions, and business continuity management. Where they are possible, harmonised standards offer the benefits of consistent treatment of risk issues across APRA-regulated industries and the ability to quickly migrate best prudential practice from one to all of these industries.

APRA's capabilities

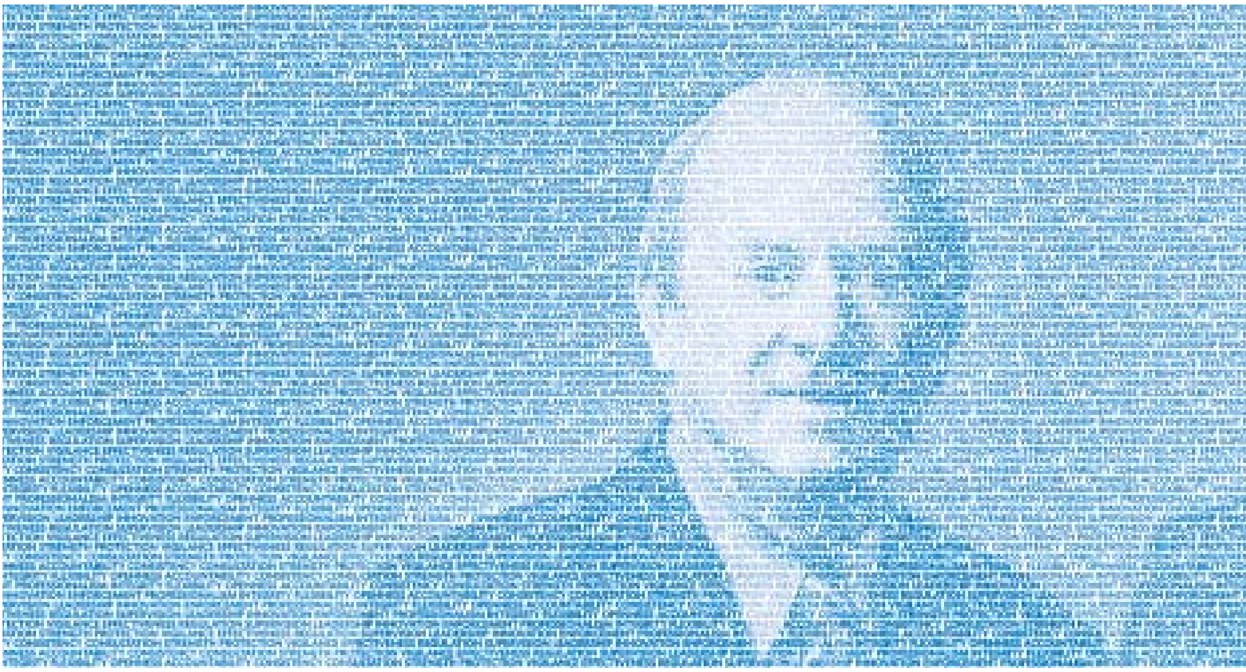
APRA's 'radar' and risk analysis has been considerably sharpened through its more sophisticated system for risk-rating supervised institutions. This system draws together all of APRA's intelligence on an institution in a highly structured and consistent way, to allow supervisors to form a judgment on the overall riskiness of the institution and the supervisory stance APRA should take. Some 1,500 entities accounting for over 98 per cent of APRA-regulated assets have now been rated, and a significant number have been re-rated one or more times. Over the year, the number of institutions upgraded from APRA's more intense supervisory stances after APRA intervention provided confirmation that the system has helped APRA supervisors to identify risks early and work with institutions to address them.

Matching the sharper radar has been a build-up in APRA's supervisory resources and skills. APRA's approach to the supervision of large and complex institutions was exposed by the HIH failure, and by subsequent international benchmarking, as being under-resourced and in the hands of relatively inexperienced supervisory teams. Rebuilding efforts have seen staff numbers rise from a little below 400 when HIH collapsed to around 525 currently, and APRA received budgetary approval to further increase this number over the course of 2004/05. High calibre individuals with extensive experience in industry and the professions are now complementing our core of seasoned staff from predecessor agencies. Staff turnover has stabilised and, for the first time since APRA's establishment, the average length of service of staff has begun to increase.

In absorbing staff, APRA is seeking to find the optimal balance of front-line supervisors and specialist staff with detailed knowledge of specific risk, industry or technical issues. We are tilting back towards more of an industry focus by grouping institutions into supervisory branches with a bias to particular industries, and by having each of the three members of APRA's Executive Group take responsibility for specific industries. The rebalancing does not mean that APRA is retreating from the integrated regulator model. Rather, experience has taught us that the model is more effective if it works through teams which bring the right mix of skills to deal with large and complex institutions, rather than by expecting individual supervisors to be a 'jack of all trades'.

To support this rebalancing and to improve cohesion and consistency, APRA's organisation structure was changed from July 2004. Senior management of front-line supervisory divisions were freed-up to concentrate fully on day-to-day supervision and the various specialist risk, industry, technical and enforcement areas were brought together under a new Executive General Manager position.

APRA is now building-up a track record of balanced, pre-emptive and effective intervention that has helped steer a number of regulated institutions back onto a more prudent course. Inevitably, much of this work is conducted behind the scenes, with institutions willing to consult and cooperate, and this work must remain unsung. However, the decision by the National Australia Bank to release APRA's report on the rogue trading episode opened a window into the perspectives and expertise which APRA brings to risk issues.



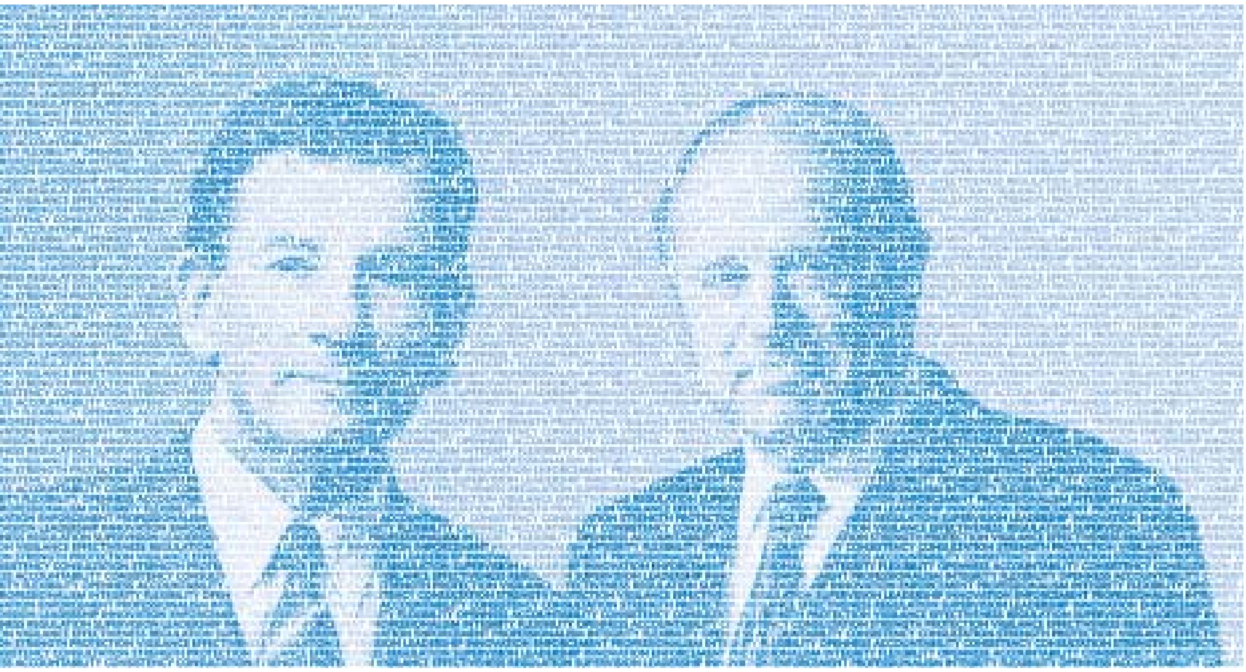
Dr John Laker, Mr Ross Jones, Mr Steve Somogyi.

Looking ahead

The year ahead promises to be just as active and challenging for APRA. The agenda for upgrading the supervisory framework already appears full. APRA has unfinished business in the general insurance, fit and proper and housing lending areas, which is being augmented by the significant work associated with Australia's adoption of new international accounting standards and the new Basel Capital Framework. The Government's response to the technical study on financial system guarantees (the Davis Report) may also have implications for the supervisory framework and for APRA itself.

In its supervisory activities, APRA will be emphasising, as it has for some time now, that Australia's continuing economic success should not dull the senses of institutions in risk management. The significant compensation payments made to investors by some major institutions because of unit pricing weaknesses were a reminder of the importance of vigilance across the risk spectrum, at all times.

The risks in housing lending will remain a major focus for APRA, particularly as housing credit growth slows to more sustainable rates. This adjustment may prove testing for deposit-taking institutions pursuing ambitious lending growth targets and under pressure to dilute credit standards to achieve them. Complacency should not be allowed to set into lending practices, though there are growing signs that it may be.



Although the general insurance industry has been able to restore profitability over more recent years, premium cycles will turn and insurers will need to resist pressures to relax their underwriting standards in pursuit of fleeting gains in market shares. Australia's history in this area is not one to repeat.

More generally, financial institutions must resist the temptation to reduce their investment in risk management capabilities in their eagerness to reduce costs and boost short-term profits. Risk management systems and staff always appear expensive in good times, but such expenditure will prove amply justified in the face of adversity, from which no institution is immune.

APRA's staff

Summing up, the Executive Group believes that APRA today is a revitalised and more confident prudential regulator, and it will become more so as a number of improvement programs, particularly in training and our supervisory processes, bear fruit. This progress has been a genuine team effort. APRA staff well understand that the community looks to them for vigorous and effective performance and they have responded, during the year, in a spirit of professionalism, pride and commitment which augurs well for APRA's future. We thank them for their support.

J. F. Laker

Dr John F. Laker
Chairman

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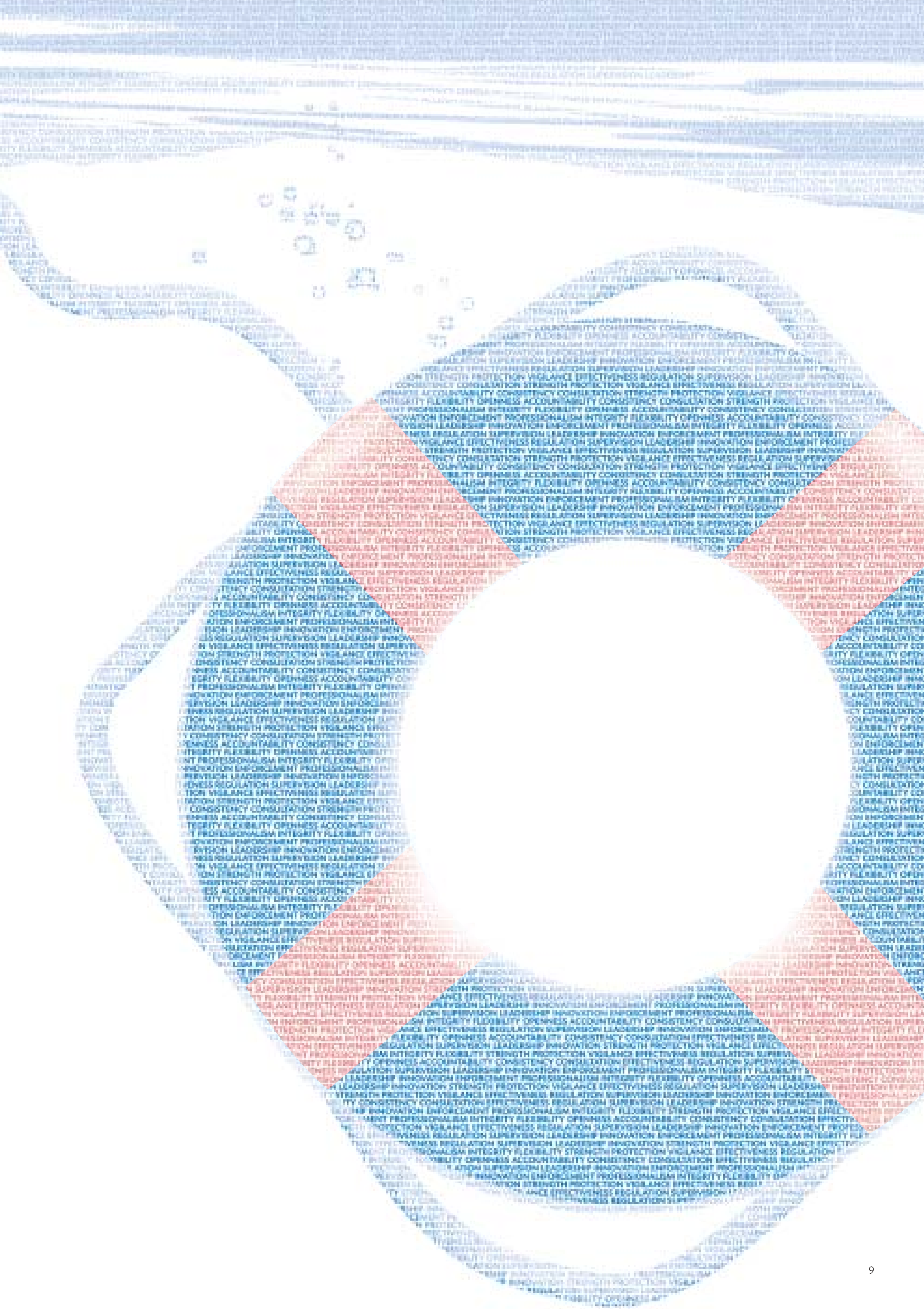
APRA'S SUPERVISORY APPROACH

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, enabling it to deploy its resources more effectively and prioritise its dealings with supervised entities. During 2003/04, APRA also commenced a major review of its supervisory processes aimed at improving the consistency of its approach.



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 PAIRS, supervised institutions are classified according to the probability that an institution may be unable to honour its financial promises to beneficiaries. APRA assesses the likelihood that an institution could fail over the medium term 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.

APRA currently supervises more than 10,000 entities and, of these, some 2,500 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 2004, almost 1,500 entities, accounting for over 98 per cent of APRA-regulated assets, had been PAIRS-rated. They included some 119 entities rated as 'Extreme' or 'High' impact because of their size; these entities represent around 90 per cent of APRA-regulated assets and were the first group to be rated.

More than half of the institutions suitable for PAIRS rating are superannuation funds with assets of less than $50 million; collectively, these account for less than one per cent of total APRA-regulated assets. To expedite the PAIRS assessment of this very large number of relatively small institutions, a simplified PAIRS model and rating process was implemented in November 2003. Efforts are underway to investigate whether some, or perhaps all, of the analysis supporting the rating of these small superannuation funds can be automated, using data derived from recently revised annual statistical returns.

A PAIRS panel within APRA reviews the ratings of each 'Extreme' and 'High' impact entity. 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. For the lower impact entities, statistical analysis is used to identify ratings that appear out of line and these are referred to relevant supervisors and managers for reconsideration. APRA also received data and risk-rating information from four credit rating agencies, a corporate governance advisory service and a data warehouse for Australian superannuation funds. These services augment APRA's PAIRS risk model and support APRA's transition to a more analytical, data driven supervisory approach.

Under the SOARS system, the risk-rating of an institution helps APRA to determine its supervisory response. There are four supervisory stances involving increasing intensity in APRA's involvement. '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. Institutions in 'Mandated Improvement' are also unlikely to fail but they exhibit one or more unacceptable risk features. These institutions must have a sensible improvement plan and they are typically subject to firm supervisory intervention, often via formal directions or enforceable undertakings. At the end of the scale, institutions in 'Restructure' need new capital, management or ownership, or possibly all three, and these institutions are subject to vigorous supervisory intervention. These are the institutions in which APRA has lost confidence that financial promises to beneficiaries will be met in the absence of active intervention.

Under APRA's new supervisory methodology, the larger a financial institution and the greater its significance for overall financial stability, the earlier APRA would intervene if risk issues emerged that threatened the institution. APRA's willingness to intervene, however, must be balanced with care to avoid unnecessary damage to or interference with these institutions. For that reason, APRA's first supervisory action is normally to gather more information. This is not excessively intrusive on the regulated institution and often leads to no further action on APRA's part. On the other hand, if the probing confirms that there is a potential problem, APRA will intensify its intervention.

Over 2003/04, the number of institutions upgraded from the 'Mandated Improvement' stance considerably exceeded the number in that category that were downgraded to 'Restructure' or that exited the industry. This provides some confirmation that the PAIRS/SOARS framework has helped to improve the timeliness and effectiveness of APRA's intervention.

SOARS supervisory stance

PAIRS impact rating	PAIRS probability rating: Low	Medium – Low	Medium – High	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

During the year, APRA commenced a major project to review its supervisory processes and develop a consistent APRA-wide supervisory framework. The framework is made up of a series of industry-based procedures, work instructions and resources to support supervisory practices. Underpinning the framework is APRA's supervision policy, which in documented form sets out APRA's approach to supervision and describes the various tools used to perform this task. This will enable all of APRA's supervisors, irrespective of their division or geographic location, to have access to a standard set of guidance and other material to assist them in their day-to-day work.

APRA expects this project to deliver significant efficiency gains and provide a better structured and more consistent supervisory approach. This will also be to the benefit of supervised institutions and APRA beneficiaries. The modules for superannuation and general insurance have now been introduced and those for authorised deposit-taking institutions (ADIs) and life insurance will be in place by early 2005.

Supervision activity

APRA has an active program of direct contacts with supervised entities through on-site visits, consultations and tripartite meetings (involving the supervised entity and its external auditor). The number of such contacts in 2003/04 was higher than the previous year in the life and general insurance sectors but lower for ADIs and superannuation funds, consistent with the continuing consolidation within these two sectors and an emphasis on longer and more targeted visits to entities based on PAIRS ratings.

APRA was involved in two substantial supervisory issues during 2003/04 which required an intensive effort from front-line supervisors and specialist staff, and close cooperation with other regulatory agencies in Australia and overseas. One was the demerger of AMP, a complex exercise which involved significant regulatory review both in Australia and by the Financial Services Authority in the United Kingdom. APRA used its formal powers to ensure that Australian policyholders and depositors of AMP would remain protected. The second was the discovery of irregular foreign currency option trading at the National Australia Bank, which is discussed later in this Report.

TABLE 1
APRA visits, consultations and tripartite meetings

Entity	2002/03	2003/04
ADIs	263	207
Friendly societies	26	16
General insurers	87	96
Life insurers	10	23
Approved Trustees	79	45
Superannuation funds	802	683
Conglomerates	42	29
Total	**1,309**	**1,099**

Enforcement

As a prudential regulator, APRA has relatively less recourse to formal enforcement action than have other Commonwealth law enforcement agencies. Rather, wherever practicable, APRA seeks through its authorisation processes, prudential standards, early warning systems and other preventative measures to guard against problems emerging in regulated entities. APRA does, however, take enforcement action from time to time when more direct action is required. APRA devotes some eight per cent of its staffing resources to enforcement activity.

APRA's enforcement activity aims to minimise financial losses to beneficiaries by limiting the immediate damage caused by a troubled entity (the 'containment effect') and by sending a public message that industry generally can observe and absorb (the 'deterrent effect'). The containment aspect is generally the more immediate priority, and may require keeping enforcement action confidential for a time so as not to compromise any rescue measures. The deterrent aspect, on the other hand, is generally less urgent but requires wide publicity to have maximum impact.

During 2003/04, APRA undertook some 391 enforcement actions, around the same level as the previous year, while the number of significant cases being actively managed by APRA's enforcement team remained broadly constant at around 40. Some of these cases involved major investigative effort and consumed substantial resources.

A key enforcement technique is the power to conduct a forensic investigation. APRA initiates formal investigations of regulated entities suspected of breaching their statutory obligations under the relevant prudential legislation – e.g. the *Insurance Act 1973* or the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) – by appointing an in-house or external Inspector for the task. Investigations conducted by APRA Inspectors are fact finding and evidence gathering exercises that involve demands for information from the entity concerned, interviews of relevant personnel and analysis of the circumstances that are revealed. The findings of an investigation, with supporting evidence, form the basis for subsequent enforcement action.

During the year, APRA had 15 investigations in progress. Some of these were continuations of investigations commenced in previous years and culminated in formal enforcement action.

In one such case, APRA continued its investigation into the Harts Australia Staff Superannuation Fund, which has been under the management of an APRA-appointed Acting Trustee since October 2001, when the Steven Hart accountancy group failed. Following advice from its Inspector, APRA in April 2004 disqualified two former trustee directors of the Fund who were considered to have abrogated their responsibilities, and it is also seeking to enforce an in specie employer contribution to the Fund – a mortgage over land in South Australia – by taking action in the South Australian Supreme Court in the name of the Acting Trustee.

During the year, APRA sought to act on the findings of its earlier investigation into the affairs of a small general insurance company, Rural & General Insurance Ltd (Rural & General). This followed APRA's decision in June 2002 not to re-authorise the company under the revised *Insurance Act 1973* due to concerns about its capital and governance. In March 2003, APRA's Inspector reported that Rural & General may be in a negative net asset position, as defined in the *Insurance Act 1973*. In September 2003, APRA sought Orders in the Federal Court to have Rural & General placed in provisional liquidation, but this action was withdrawn in March 2004 after creditors agreed to a Deed of Company Arrangement put to them by administrators appointed by the insurer. APRA took the view that the Deed had achieved a similar outcome to the Orders and that it was no longer in the public interest to continue with the proceedings.

APRA continued its investigation into the Wall & Ceiling Superannuation Fund, which had around 130 members employed in the building supplies industry and had assets invested through unit trusts in commercial property that was leased back to employer-sponsors. The trustee had no direct control over the underlying assets. APRA took the view that the Fund's investments lacked adequate diversification and liquidity, and involved conflicts of interest. APRA secured Enforceable Undertakings from the trustee and other relevant parties to sell the properties, return cash to the Fund and then wind it up. APRA alleges the Fund was set up primarily to serve the commercial interests of the employer-sponsors, and that personnel associated with the Fund contravened the in-house asset provisions of the SIS Act. In July 2004, APRA disqualified 13 individuals associated with the Fund, including three accountants and auditors to the Fund. APRA's investigation is continuing.

APRA also continued its investigation into the Perth-based Strategic Capital Superannuation Fund, and identified a number of serious contraventions of the SIS Act by the former trustee, which had been removed by APRA in April 2003. These contraventions included imprudent, inappropriate and non-arm's-length investments. As a result, four former trustee directors were found to be unsuitable to hold responsible positions in the superannuation industry, and were formally disqualified in August 2004. APRA is still gathering evidence in this case, with a view to considering whether further action is warranted. APRA is liaising with the Australian Securities and Investments Commission (ASIC), which is also investigating the case, to ensure that evidence gathering and any potential recommendations for prosecution by the two agencies are coordinated.

APRA also commenced formal investigations during the year. In August 2003, APRA appointed an Inspector into the affairs of Australian Superannuation Nominees Ltd (ASN), an Approved Trustee of Small APRA Funds (SAFs), following concerns about its capital structure, investment controls and governance standards.

The Inspector's report, received in June 2004, is under consideration. APRA had earlier taken regulatory actions against ASN, but these were appealed and either discontinued on Counsel's advice, or in one instance overturned in the Administrative Appeals Tribunal. In June 2004, with key APRA issues still unresolved, ASN advised APRA that it would retire as a trustee and that the superannuation funds under its management would be transferred to a completely independent Approved Trustee. APRA has approved the transfer.

In October 2003, APRA commenced an investigation to clarify the financial condition of Reward Insurance (Reward) – a small Victorian general insurer writing home warranty, householder and commercial insurance – when Reward failed to meet its regulatory capital requirements. Later that month, Reward notified a further deterioration in its capital position following advice from its Approved Actuary that the company was substantially under-provisioned, and the company was put on notice that an orderly exit was required. A buyer for the business was sought and, in December 2003, the OAMPS insurance group agreed to buy the insurance book with a view to continuing the home warranty business, and Hollard Insurance agreed to buy the householder renewals. APRA and Federal Court approval followed in February and the transaction was completed in March, resulting in the revocation of Reward's general insurance authority.

In June 2004, APRA appointed an Inspector to investigate the history of certain reinsurance transactions (now unwound) in Zurich Australia Insurance Limited's (ZAIL) general insurance business. At the same time, an independent liability valuation undertaken at APRA's initiative confirmed that ZAIL was more than adequately meeting minimum regulatory capital requirements, and the parent company has also given undertakings to maintain ZAIL's capital strength. APRA's investigations are continuing.

As a consequence of its various investigations, APRA disqualified 34 individuals in 2003/04, compared with 16 individuals the previous year. APRA has the power to disqualify key personnel who have proven to be unsuitable (being, for example, incompetent or dishonest or compromised by conflicts of interest) in superannuation and general insurance, and comparable powers in the ADI sector are being finalised. Disqualification serves to protect APRA-regulated industries from individuals whose conduct has breached required standards of conduct, including fitness and propriety. The disqualifications in 2003/04 were all in the superannuation industry, where the greater bulk of regulated entities reside. In response to the recommendations of the HIH Royal Commission, APRA has also been assessing whether a number of individuals involved in HIH Insurance meet the standards of fitness and propriety required to remain in the general insurance industry.

During 2003/04, in conjunction with ASIC, APRA also dealt with a number of unit pricing issues which resulted in significant compensation being paid to investors. In September 2003, it agreed a series of actions with the National Australia Bank following the discovery of unit price errors in statutory funds held in three bank subsidiaries. Enforceable Undertakings were entered into with MLC Nominees Pty Ltd and National Australia Superannuation Pty Ltd and a direction under the *Life Insurance Act 1995* was issued to National Australia Financial Management Ltd, specifying a number of remedial actions in relation to unit pricing and corporate governance. In April 2004, APRA gave directions to AMP Life Limited (AMP Life) in relation to eight superannuation products administered by that company, following AMP Life's reporting that it had excluded the tax benefit of imputation credits and other tax allowances in the unit prices of these products. The directions, given under the *Life Insurance Act 1995*, required AMP Life to compensate policyholders of the affected funds.

During the year, APRA undertook a major exercise to track down over 2,800 funds on its superannuation database that had failed to lodge successive annual returns, and were effectively lost. Many of these funds had made an initial election to be regulated under the SIS Act, generally in 1995, but had failed to make contact with the prudential regulator since then. After searching numerous records and directories, and dispatching over 22,000 messages by letter, email and telephone to last known addresses and numbers, APRA located a number of funds that are now either in compliance with the SIS Act, or subject to action to bring them into compliance. Numerous other funds were found not to have existed or to have been wound-up. For another 500 funds that remained uncontactable, APRA disqualified and removed the existing trustee and appointed an Acting Trustee to administer a wind-up scheme. Lost superannuation funds wound-up in this way lose their potential to access tax concessions. Their assets, if any, are transferred to any members who come forward and can prove ownership, or else (in due course) will come under the unclaimed superannuation money arrangements.

Enforcement actions undertaken during the year

	ADIs		Superannuation		General insurance		Life insurance		Friendly societies		Other[1]		TOTAL	
	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**
AAT/Federal Court review			10	6	1	1				1			11	8
Amendment of IOA[2]			9	2		2							9	4
Appointment of Acting Trustee			3	3									3	3
Appointment of liquidator/Inspector			13	11	2	1							15	12
Civil litigation			1	1	1								2	1
Directions	21	6	33	89	9	5	2	2			13	25	78	127
Disqualification of auditors/directors			16	34									16	34
Enforceable undertaking			9	19		8							9	27
Follow-up delayed contributions	13		44	1									57	1
Investigation action	1		6	21									7	21
Other action	10		5	6	7	1			17	2		3	39	12
Prosecution			26										26	
Refer to other agency/police	1	4	44	30	6	9			1	4	6	30	58	77
Removal of trustee/ withdrawal of IOA/ revocation	8		6						1				15	
Show cause letter	1	2	36	54	4	7	1	1	1				43	64
Total	**55**	**12**	**261**	**277**	**30**	**34**	**3**	**3**	**20**	**7**	**19**	**58**	**388**	**391**

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

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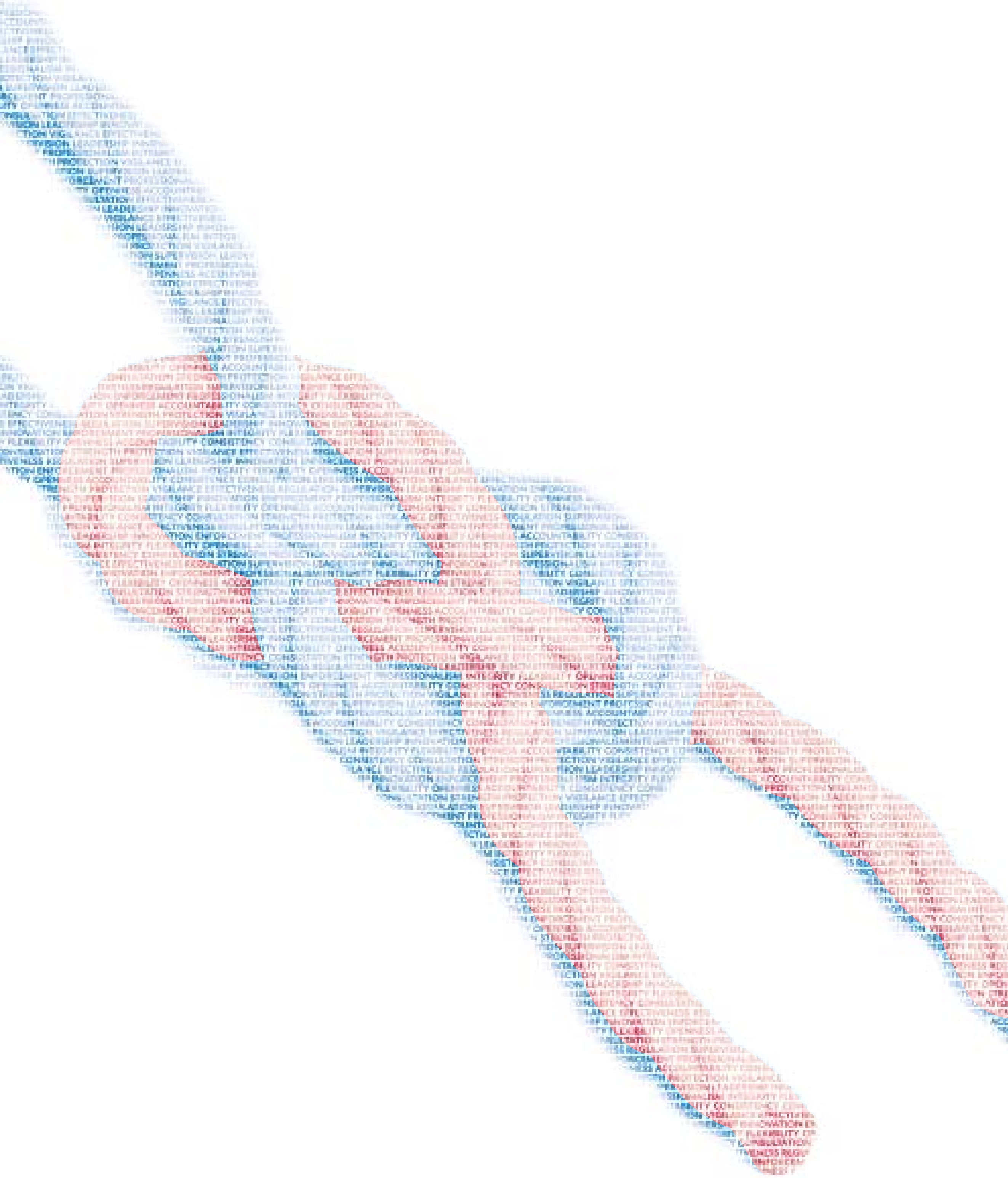
SUPERVISORY ISSUES IN 2003/04

AUTHORISED DEPOSIT-TAKING INSTITUTIONS

Authorised deposit-taking institutions (ADIs) have remained major beneficiaries of the robust economic fundamentals and strong demand for household credit in Australia. On a range of prudential indicators – such as loan arrears, large exposures, profitability and capitalisation – the ADI sector is currently in very sound condition. The focus of APRA's supervision of ADIs in 2003/04 was the underlying quality of ADI housing lending portfolios, in an environment of rising household indebtedness and debt-servicing burdens and uncertainty about the future course of housing prices.



Housing lending

Housing lending has traditionally been a very safe asset for ADIs and, at this point in the housing cycle, arrears on residential mortgages are at decade lows. Nonetheless, APRA undertook a rigorous stress test to help gauge the resilience of ADI housing loan portfolios in the event there were to be a substantial housing market correction. The stress scenario – a 30 per cent fall in housing prices and a significant increase in mortgage defaults – was well outside Australia's post-war experience but not as severe as the fate of some other industrial countries and regions over the past twenty years.

The stress test demonstrated that the ADI sector as a whole remains well capitalised and could withstand a substantial housing market correction without putting depositors at undue risk. Over 90 per cent of the ADIs that participated would survive such a shock, without breaching minimum regulatory capital requirements. For a small number of ADIs, the losses incurred would not be covered by surplus capital, but the breaches of minimum capital requirements would not be large. No ADI would fail in the face of the shock. APRA's stress scenario did not, however, allow for the more general impact of a substantial housing market correction on the quality of other ADI lending and on other profit sources.

Though the stress test results were reassuring, APRA has warned ADIs to proceed with caution in housing lending. In its supervisory activities, APRA continues to identify slippages in basic lending practices, in areas such as verification of customer data, assessments of debt serviceability and valuation processes. APRA also sees increasing reliance on the information collected by third parties (such as mortgage brokers and mortgage managers) without independent verification by the ADI. The share of ADI housing loans sourced through third parties has continued to grow and it is essential that loan quality is not compromised as a result. As discussed later in this Report, APRA has revised its policies in this area to provide more explicit guidance to ADIs.

The domestic securitisation market has both broadened and deepened over the past year, with ADIs continuing to be major issuers of residential mortgage-backed securities. APRA allows securitised assets to be excluded from the capital charge for credit risk where there is a 'clean sale' but ADIs face potential operational risks in respect to representations and warranties. Where APRA judges that an ADI is not managing these operational risks prudently, it will consider requiring a higher capital ratio.

Foreign currency options exposures

Following the announcement by the National Australia Bank (NAB) in January 2004 of losses from irregular foreign currency options trading, APRA undertook an investigation into the circumstances of these losses. The investigation covered NAB's front and back office operations, its internal control systems and its risk culture and governance framework. Following endorsement by APRA's Executive Group of the remedial actions required by NAB, APRA's report was presented to the NAB Board in March 2004. NAB subsequently made the report public, with APRA's consent.

The major area of concern identified in APRA's report was the failure by NAB to implement its approved risk control framework effectively. Those responsible for overseeing NAB's risk management failed to either identify or follow-up the many limit breaches and irregularities which presented themselves over late 2003/early 2004. APRA found significant deficiencies in back office procedures which allowed the traders to conceal their foreign currency options positions. APRA also found that there was scope for considerable improvement in the processes by which new products were introduced and NAB's internal model for determining its market risk capital was applied. On the governance front, APRA found the NAB Board and the Executive Risk Committees to be ineffective in identifying risks and taking appropriate action to rectify material risk issues.

APRA required NAB to commence a program to implement the remedial actions set out in the report, on timeframes agreed with APRA. APRA is now working with NAB on its remedial program.

APRA subsequently undertook reviews of the risk management practices of other ADIs with significant treasury operations to ensure that the issues highlighted by the NAB episode were more broadly understood and were being appropriately addressed. These reviews found areas for improvement but did not identify any serious risk management weaknesses.

Operational risk management

APRA has increased its scrutiny of risk management practices in respect of information technology and security risk issues. APRA's on-site reviews have revealed that many ADIs (and other APRA-regulated institutions) lack sufficiently robust information security frameworks. Although much work is being undertaken to address these issues, there are considerable challenges, especially for institutions that have complex systems involving legacy applications.

APRA also sees scope for those ADIs offering internet banking to improve their level of security. The past year has seen a significant rise in email scams and fake websites targeted at customers of financial institutions (so-called 'phishing' attacks) in order to obtain personal bank account information. To date, these attacks have been primarily directed at banks and the level of sophistication of these attacks has been increasing. Banks and other ADIs are working closely with the Australian High Tech Crime Centre and the Australian Computer Emergency Response Team (AusCERT) to address these threats. In addition, financial institutions and Government agencies have undertaken campaigns to raise customer awareness of the need for security in the systems they use to access their account information and undertake transactions.

GENERAL INSURANCE

In 2003/04, the continued strength in premiums (now easing in some business lines), the recovery in share markets and extended periods of dry weather took the general insurance industry to its healthiest position for some time. This outcome was also underpinned by the stronger prudential framework introduced from 1 July 2002, and by the shift to a more disciplined approach to underwriting profits. In this environment, APRA's main supervisory focus has been to ensure that recent improvements in risk and capital management become firmly embedded within industry practice before the industry again experiences significant pressures on premiums or claims experience.

Capitalisation

Under APRA's new prudential regime, capital requirements for general insurers are a risk-based measure where higher requirements are imposed on insurers with higher risk profiles. Above the absolute minimum capital of $5 million, the minimum capital requirement (MCR) is derived from a range of factors applied to an insurer's outstanding claims provision, premium liabilities and to other elements of risk. The MCR is considered to be the minimum amount of capital necessary if a general insurer is to comfortably overcome reasonably foreseeable adverse scenarios without any undue risk that it may not meet policyholder claims.

APRA expects insurers to hold an additional buffer of eligible capital above the MCR to cover the stresses and expenses of normal and planned operations at all times. It is not commercially sensible for an insurer to aim to only just meet the MCR and insurers seeking to do so would come under intense APRA supervision. APRA has determined that, in the normal course of events, the buffer should be around 20 per cent of the MCR but it may impose a higher buffer where, for example, an insurer is newly established or where APRA deems that an insurer has a disproportionate exposure to a particular type of risk. Many general insurers have themselves set much higher internal buffers and incorporate detailed capital management initiatives into their business plans, but a number of insurers need to apply more attention to the management of their capital. Though some insurers are developing economic capital models, there is a considerable way to go before these models will be robust enough to be used to determine regulatory capital. APRA is very interested in the way in which such models are used, since they can provide significant input into risk management and decision-making.

Overall, the industry is currently holding more than twice the minimum required level of capital.

Premiums and profitability

In APRA's view, appropriate premiums for all classes of insurance are essential to the prudential soundness of the general insurance industry and its long-term ability to attract capital. After a long period of poor underwriting results, general insurers (and their international counterparts) have sharpened their discipline on premium setting with the objective of achieving underwriting profits. The new prudential framework from July 2002 supports this discipline by requiring actuarial involvement in the establishment of premium liabilities (provisions for future claims on policies currently in force). This promotes the setting of insurance premiums on a basis that directly reflects the inherent risks of the business being undertaken.

APRA monitors the adequacy of insurers' processes for determining premiums and the degree to which these take into account claims experience, risk profiles and operational factors. Notwithstanding the general improvements in underwriting disciplines, some smaller players appear still to set their premiums on a 'follow the leader' basis and lack, or have ineffective, pricing models. Insurers pursuing this pricing strategy face obvious threats to their long-term viability and come under closer supervisory attention. APRA's proposed reforms to the prudential framework for general insurance will further improve the scrutiny of premium setting decisions. The proposals require general insurers to obtain a Financial Condition Report from their Approved Actuary, which will include a particular focus on the adequacy of premiums.

Risk management and reinsurance strategies

The prudential framework requires insurers to develop and implement a Risk Management Strategy (RMS) and a 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. APRA reviews the RMS of each general insurer as it is updated. Experience to date is that RMS documents vary in the depth and breadth to which they address risks. Some insurers have considered the various risks comprehensively, while others paint with a broad brush and do not provide sufficient detail in their RMS to enable APRA to form an opinion on their awareness of risk exposures or on the viability of their risk control measures. In such cases, APRA looks for a significant improvement in RMS documentation.

The REMS requires an insurer's board to set and document the insurance risk appetite for the institution, and to satisfy itself that there are sound systems for selecting, implementing and monitoring reinsurance programs. In APRA's experience, the quality and content of REMS also varies considerably across the industry. Many insurers have developed good quality REMS, but not all have well-founded procedures to ensure that REMS are implemented and kept under review (in the event, for example, that the credit rating of reinsurers is downgraded). More generally, the contractual documentation of reinsurance treaties needs improvement. APRA's proposed reforms to the prudential framework seek to strengthen the role of REMS and impose greater discipline on contractual documentation.

Liability valuation

In valuing their insurance liabilities under the new prudential standards, insurers may take account of a range of diversification benefits arising from factors such as geography, lines of business, etc. These benefits are based on assumptions established by the insurer's Approved Actuary. In the early application of the standards, actuaries have tended to make more use of general guidance included in the practice standards of the Institute of Actuaries of Australia, than of the insurer's own data. However, industry benchmarks are not likely to mirror the diversity within an insurer's own portfolio and the insurer may be assuming greater (or lesser) benefits than are justified by its particular circumstances.

The actuarial assumptions used for both central estimate calculations and diversification benefits is an area requiring more work. APRA has commenced a review of the assumptions and methods used by general insurers to determine central estimates, comparing a sample of assumptions used by Approved Actuaries across similar portfolios. Preliminary indications suggest that there is a wide diversity of approaches used and, while there may be good reasons for this, there may be a case to develop minimum criteria that need to be examined by the Approved Actuary in determining liability valuations.

Governance

The prudential framework requires that insurers establish a Board Audit Committee, if they did not already have one in place. This is designed to ensure appropriate scrutiny of internal and external audit findings, as well as of other risk-based reviews which may be undertaken.

While insurers have complied with the new requirements, APRA is still finding cases where the implementation and operation of audit committees could be improved. Instances have been found where audit committees, while setting and approving internal and external audit programs, have not been receiving and reviewing the findings of audit activities. In other cases, the depth of material provided to the audit committee was insufficient to allow the members to adequately understand and assess the issues that had been identified.

APRA's supervision work has also identified weaknesses in internal audit processes in some insurers. The weaknesses include inadequate resourcing of the internal audit team, when viewed against the complexity of the institution and comparable entities, and inadequate internal controls in the absence of an internal audit team.

As part of its assessment of the governance of general insurers, APRA has been reviewing the information provided to boards and the adequacy of board minutes. The findings show a considerable diversity of approaches – some insurers arguably provide too much information to boards and others clearly too little. The discipline and processes around flows of information to boards have been the subject of a special 'agreed-upon procedures' review by external auditors for all of the larger insurers.

National Claims and Policies Database (NCPD)

During 2003/04, APRA has been consulting extensively with the insurance industry and other relevant stakeholders on the collection of policy and claims data for public liability and professional indemnity insurance. The NCPD, an initiative of the Government, is aimed at assisting the industry in determining appropriate premiums and developing suitable insurance products. It is also intended to enable the Government, the community and insurers to identify trends and implement changes that would reduce the incidence of, or lower costs of claims for, these classes of risks.

All APRA-regulated general insurance and reinsurance companies providing liability insurance to businesses and professionals will be required to provide data in accordance with reporting standards made under the *Financial Sector (Collection of Data) Act 2001*. Following consultations, the data specifications for the NCPD were finalised in January 2004 and reporting standards to implement the NCPD were tabled in June 2004. Insurers will be required to provide NCPD data for the first reporting periods (covering 1 January 2003 to 30 June 2004) early in 2005, and every six months thereafter.

APRA is currently undertaking a public tender process to appoint a service provider for the development, implementation and ongoing management of the NCPD and expects to make an appointment in November 2004.

LIFE INSURANCE AND FRIENDLY SOCIETIES

The weakness in domestic and global equity markets which had weighed on the life insurance industry for some time passed when equity markets staged a strong recovery after March 2003. Although some momentum has been lost since then, share prices remain significantly above recent lows. Whilst well-capitalised and now financially stronger, the life insurance industry faces obvious competitive pressures with the shift away from traditional life insurance products to investment-linked fund management products, for which there are many alternative providers. APRA's supervision of life insurers and friendly societies over 2003/04 took into account the competitive environment and also dealt with some on-going prudential issues, such as unit pricing and legacy systems, which confront other superannuation providers as well.

The competitive environment

In response to stiff competition for superannuation and wealth management products, and lacking the economies of scale of the major wealth management groups, many life insurers and friendly societies are reassessing their overall strategy and are diversifying into other sectors. Many of these institutions are also reviewing the way in which they issue products, since there can be significant commercial advantages in providing wealth management products through unit trusts rather than as a life insurance or friendly society policy. Risk products, such as traditional life or disability insurance, must be issued through a life insurer but there are many more options available for savings products. APRA is continually monitoring the direction of the industry to ensure that appropriate safeguards exist for both new and existing policyholders.

Target surplus

The level of 'free assets' which a life insurer should hold above its regulatory capital requirements has been the subject of considerable debate within the industry and the actuarial profession, a debate which APRA welcomes. APRA expects boards to develop a framework for determining target surplus and managing the level of free assets, so as to avoid a breach of APRA's prudential requirements, and a number of life insurers are moving in this direction. Though the target surplus is a matter for a life insurer itself, the level of this surplus and its management is an influence on APRA's supervisory stance towards an insurer.

Transitional tax relief

From 1 July 2005, the transitional relief provided by the Government to life insurers on taxation on fees from superannuation and annuity business will come to an end. This will have a significant impact on the after-tax profits of life insurers and on their continued willingness to provide investment-linked superannuation and annuities through the life insurance framework. APRA is discussing with life insurers the strategies they will be adopting in response to the loss of transitional tax relief.

Unit pricing

During 2003/04, APRA was involved in a number of actions with institutions relating to unit pricing errors, which led to significant compensation being paid to customers. Since most of Australia's superannuation assets are invested in unit-linked arrangements, it is critical that the methodologies used by institutions to determine unit prices be fair, equitable, accurate and robust. Following its earlier review of unit pricing practices and issues, APRA has now joined with ASIC to undertake a more detailed review to identify poor practices in this area, have them corrected and promote best practice across the life insurance and superannuation industries.

Legacy products and systems

Many life insurers have significant portfolios of traditional policies, such as whole-of-life and endowment policies, that are closed to new business and winding-down rapidly. A number of insurers have also inherited products through mergers and acquisitions. Many of these legacy products are run on old IT systems, have numerous and varied versions and are thus becoming more difficult to administer; they are also generating a significant number of customer complaints as experienced staff are lost. APRA's concern is to ensure that life insurers are able to meet their long term promises to policyholders and maintain adequate systems and processes for legacy products. The operational risks posed by legacy products are well known to the life insurance (and superannuation) industry and APRA has engaged in a number of industry forums on this issue. In the case of traditional 'participating' policies where bonuses are still declared, APRA also seeks to satisfy itself that policyholders continue to be treated fairly and equitably.

SUPERANNUATION

The recovery in equity markets in 2003/04 has enabled the superannuation industry to move strongly 'into the black' after a period of low investment returns. This has helped the industry to concentrate more fully on the Government's reforms to superannuation, discussed later in this Report, and other legislative initiatives. APRA's priorities have been to prepare for these reforms and to investigate and respond to prudential issues that have arisen from its day-to-day supervisory activities.

Defined benefit funds

A 'health check' of defined benefit superannuation funds conducted the previous year had raised concerns about funding shortfalls in a number of funds, and APRA has been working with trustees and employers to ensure that funding is restored to more appropriate levels. The recovery in investment markets, if it proves durable, will go some way to mitigating these concerns, and APRA will continue to provide guidance to individual funds on what it considers to be a satisfactory funding position. To assist trustees in managing funding deficits, APRA is drafting a circular on trustee responsibilities in relation to defined benefit funds.

Family law changes regarding superannuation

The introduction of the *Family Law Legislation Amendment (Superannuation) Act 2001* has enabled superannuation interests to be divided when spouses separate. Interests may be divided by way of agreement (prior to marriage) or by court order, and superannuation interests may be taken into account when dividing the other property.

These new arrangements require amendment to established superannuation practices and administration systems. Many of the governing rules of superannuation funds do not permit a new interest to be created for a non-member spouse, and these rules will need to be changed. APRA has been reviewing the capacity of administration systems to cope with these more complex requirements and the manner in which the additional operational risks will be mitigated. APRA is working with the superannuation industry to ensure that the legislative change is accommodated prudently. It is also boosting the training of its own supervisory staff in this area to enable it to assist superannuation funds in complying with both family and superannuation laws.

Insurance

APRA is aware that some superannuation funds have had difficulty obtaining appropriate insurance cover. In some instances, funds have had concerns relating to the availability and affordability of professional indemnity insurance, runoff insurance coverage and coverage for insurance benefits which may be offered to members in fund governing rules. APRA is alert to these difficulties and in the licensing process it will consider the adequacy of the trustee's broader resourcing position and related risk controls.

Supervision of sub-funds

As the supervision industry consolidates, sub-funds within superannuation funds (that is, funds with separately identifiable assets and beneficiaries under a master fund or trust) are becoming more common. Sub-funds are often former corporate funds which have been transferred to a master fund to benefit from economies of scale from having a single trustee and a common administrative support framework. The SIS Act treats, and APRA regulates, the master trust as a single entity although there are a number of of SIS Act provisions which refer to sub-funds, such as in-house asset rules, member protection and some actuarial reporting requirements.

Sub-fund arrangements give rise to certain prudential risks that must be identified and addressed by trustees. APRA will be stepping-up its supervision of sub-fund activity to identify prudential issues and to ensure that the exposure of fund members to potential problems is minimised. APRA will also be providing relevant guidance to funds.

Auditors

The superannuation reforms place particular emphasis on the roles of auditors in certifying the compliance of trustees with the amended SIS Act and its supporting regulations. APRA has been liaising closely with representatives of superannuation fund auditors to discuss emerging issues, and will be providing more detailed guidance for auditors to assist them in fulfilling their obligations. To this end, APRA will be releasing an update of the audit superannuation circular.

ANAO performance audit on superannuation

In September 2003, the Australian National Audit Office (ANAO) tabled its performance audit on *APRA's Prudential Supervision of Superannuation Entities*. The ANAO review found that the prudential regime for superannuation is generally sound and effective. It made some specific recommendations designed to improve APRA's supervision of superannuation entities, dealing with APRA's risk-based supervisory methodologies and reporting on superannuation funds. APRA accepted all of these recommendations and has been implementing them over the course of the year.

APRA-regulated institutions

APRA-regulated institutions	Number 30/06/2003	Number 30/06/2004	% change from previous year	Assets ($ billion)[1] 30/06/2003	Assets ($ billion)[1] 30/06/2004	% change from previous year
ADIs[2]	256	247	-3.5	1,114.1	1,290.9	15.9
Banks	51	52	2.0	1,068.0	1,240.9	16.2
Building societies	14	14	0.0	13.0	14.8	13.8
Credit unions	187	177	-5.3	28.6	31.1	8.7
Other ADIs	4	4	0.0	4.5	4.1	-8.9
Representative offices of foreign banks	24	20	-16.7	n.a.	n.a.	n.a.
General insurers	143	142	-0.7	73.8	80.1	8.5
Life insurers	40	37	-7.5	181.5[3]	191.7[3]	5.6
Friendly societies	35	32	-8.6	6.1	6.0	-1.6
Approved Trustees	158	150	-5.1	n.a.	n.a.	n.a.
Superannuation entities	10,610[4]	9,980[4]	-5.9	340.0	396.8	16.7
Public offer funds	323	295	-8.7	212.7	256.4	20.5
Non-public offer funds	1,830	1,426	-22.1	119.3	132.5	11.1
Small APRA Funds	7,990	7,843	-1.8	2.8	2.7	-3.6
Approved deposit funds	293	258	-11.9	1.0	0.9	-10.0
Eligible rollover Funds	14	15	7.1	4.2	4.3	2.4
Pooled superannuation trusts	160	143	-10.6	37.9[5]	37.4[5]	-1.3
Total	**11,266**	**10,608**	**-5.8**	**1,715.5**	**1,965.5**	**14.6**

1 Asset figures for end June 2004 are based on the most recent returns. Asset figures for end June 2003 have been revised slightly from *APRA Annual Report 2003* in line with audited returns received during the year.
2 The ADI classification does not include representative offices of foreign banks.
3 Total life office statutory fund assets backing Australian policyholder liabilities.
4 Does not include uncontactable funds that are in the process of being formally wound-up or transferred to the Australian Taxation Office. As at end June 2004, there were 504 such funds, down from an estimated 1,343 funds as at end June 2003.
5 PST assets not included in totals as funds are already recorded in other superannuation categories.

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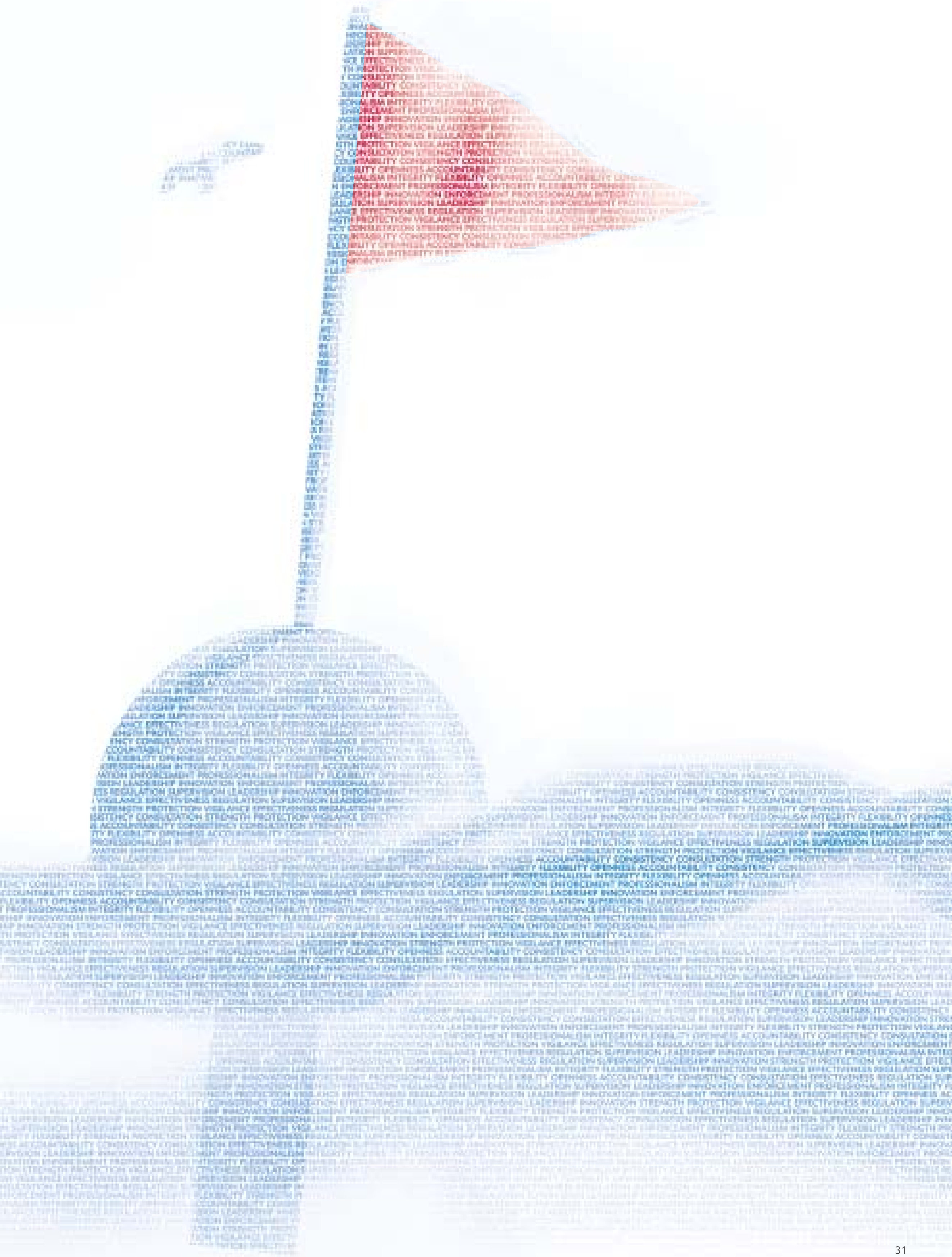
THE PRUDENTIAL SUPERVISION FRAMEWORK

APRA's priorities in the development of the prudential supervision framework over 2003/04 were determined largely by the recommendations of the HIH Royal Commission and by the Government's reforms to superannuation. In two other major areas – the new Basel Capital Accord and the introduction of International Financial Reporting Standards (IFRS) – the agenda is being set internationally. APRA also took steps to tighten the capital adequacy framework for housing lending by ADIs and for the provision of lenders mortgage insurance. It also began to release draft prudential standards on a cross-industry basis.



General insurance reform

The HIH Royal Commission made 21 recommendations directly relevant to APRA's responsibilities and to the prudential framework for general insurance. The Government has responded to these recommendations and, in November 2003, APRA released a discussion paper, *Prudential Supervision of General Insurance – Stage 2 Reforms*, on a proposed second round of general insurance reforms. The new prudential framework has helped to strengthen the position of the general insurance industry but the HIH Royal Commission concluded that the framework could be strengthened.

The discussion paper outlined proposals to:

- revise the existing prudential standards and guidance notes for general insurers, covering corporate governance matters among others, in light of experience and market developments; and
- increase disclosure about the activities of general insurers, by insurers themselves and by APRA, in order to promote market discipline.

APRA received almost 80 submissions in response to the proposals and it has been meeting with respondents. In June 2004, it co-hosted a seminar with the Insurance Council of Australia which provided a further opportunity for APRA to set out its perspective on reform and for the industry to respond.

Over the coming year, APRA plans to continue the consultation process and will develop further discussion papers and draft prudential standards for public comment. Subject to this consultation process, APRA anticipates finalising most of the proposed changes to the prudential standards for general insurance during 2005. On disclosure issues, APRA will be monitoring developments in the adoption of IFRS before finalising its views.

In a further response to the HIH Royal Commission recommendations, APRA will be releasing a discussion paper, *Supervision of Corporate Groups Involving General Insurers*, setting out proposals in relation to group structuring, measurement of capital adequacy, management of risk concentrations and other risk management issues for corporate groups involving general insurers. Development of this framework will involve considerable input from industry, with finalisation planned for 2006.

Superannuation licensing

The Government's superannuation safety reforms came into effect from 1 July 2004 through amendments to the *Superannuation Industry (Supervision) Act 1993*. Overall, the reforms will enhance APRA's ability to identify and respond to potential threats to the interests of superannuation fund members.

The reforms establish a new superannuation licensing regime involving compulsory licensing for trustees of all APRA-regulated entities, registration of those entities and risk management requirements for trustees and entities. There are three classes of licence – a public offer class, a non-public offer class and an extended public offer class for those trustees licenced to operate both public and non-public offer superannuation services. Trustees will have to meet the requirements of these licences, as well as operating standards covering such matters as risk management, fitness and propriety, outsourcing and the adequacy of resources. These operating standards also came into effect from 1 July 2004 and are supported by guidance material produced by APRA; they apply to trustees who have been licensed by APRA.

In addition to the licensing requirements, the reforms strengthen APRA's powers in respect of the funding and solvency of defined benefit funds, and augment the responsibilities of auditors and actuaries for reporting breaches of prudential requirements.

The reforms provide for a two-year transition period during which existing trustees who wish to continue their trustee operations must apply for a licence. Trustees that choose not to be licenced or that fail to meet the licence criteria must transfer any funds they operate to a licenced trustee by the end of the transition period. Currently, there are around 1,400 trustee entities responsible for over 10,000 superannuation funds.

APRA has established a dedicated team to coordinate the licensing task and it is now assessing applications. APRA is also holding a series of workshops in most Australian capital cities to assist trustees with the licensing and registration processes. Trustees should now be considering how their fund, its rules and its administration shape up against the licence criteria, rather than wait until towards the end of the transition period.

New Basel Capital Accord

In June 2004, the Basel Committee on Banking Supervision (the Basel Committee) released its updated capital adequacy framework, now known as the Basel II Framework. The Framework, which provides more risk sensitive capital requirements for deposit-taking institutions, is largely unchanged from the third consultative document released in April 2003.

The Basel II Framework has three key elements:

- new and considerably more sophisticated minimum capital requirements, including specific capital charges for operational risk (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 will require all ADIs to adopt the Basel II Framework, which will be implemented in Australia through APRA's prudential standards. It is anticipated that draft standards will be released for public comment by early 2005.

The Basel Committee has made all but the most advanced Basel II approaches available for implementation from the end of 2006, with the most advanced approaches available a year later. APRA is currently consulting with ADIs on whether it should implement all approaches – the standardised, the foundation and advanced internal ratings-based approaches for credit risk and the advanced measurement approach for operational risk – on a common starting date from the end of 2007.

The Basel Committee has consistently maintained that the Basel II Framework should at least maintain the overall level of capital in the banking system. The new Framework, however, acknowledges that the current Basel capital accord generally overstates the risks associated with housing lending. APRA supports the Basel Committee's views about the overall level of capital. Nonetheless, it accepts that some modest reductions in regulatory capital may be appropriate for ADIs in Australia because of the relatively heavy weighting of housing loans in their lending portfolios, though the new capital requirements for operational risks will be somewhat of an offset.

APRA also supports the principle underlying the Basel II Framework that capital requirements for deposit-taking institutions should acknowledge investments in better risk management systems. For some years, a number of internationally active banks have been seeking to improve their risk management systems by developing sophisticated approaches to credit risk management and by introducing economic capital models, which estimate a capital buffer against potential losses inherent in the risks in a business. The larger Australian banks have been at the forefront of that work and APRA acknowledges that such models can be valuable tools in managing risk and creating incentives to reduce risk. However, APRA concurs with the views of the Basel Committee that the models are not yet sufficiently robust, nor are the outcomes sufficiently comparable, to be used to calculate regulatory capital. As a consequence, the new Basel II Framework has been created as a 'half-way house' between the current Basel capital accord and the full use of economic capital models.

Against that background, APRA will adopt a cautious approach to agreeing to reductions in regulatory capital associated with the advanced approaches while it becomes comfortable with the quantitative estimates and methodologies used by the institutions concerned. This caution is based in part on the fact that, because of the long period of sustained economic growth in Australia, back-testing data covers only a limited range of mostly good economic experience. In addition, the larger Australian banks are still reviewing and, in some cases, revamping the models and methodologies they will be using and, at least in some product segments, will have limited opportunities to demonstrate that they meet the requisite use and experience tests. Nonetheless, ADIs implementing the more advanced approaches, other things being equal, can expect a meaningful reduction in minimum regulatory capital requirements.

International Financial Reporting Standards (IFRS)

Australia has committed to adopting IFRS from 1 January 2005. This will be a significant exercise for APRA-regulated institutions which will demand considerable board and management attention. During the year, APRA surveyed the ADI, life and general insurance industries to raise the level of awareness about IFRS and to assess preparedness for IFRS adoption. APRA's expectation is that the great majority of APRA-regulated institutions will make a successful transition to IFRS but the transition for some institutions could increase operational risks.

The adoption of IFRS will require APRA to revise its prudential standards and statistical reporting requirements, although the impact is not uniform across APRA-regulated industries. APRA has made clear its intention to avoid undue disruption and will not be rushing its normal consultation processes. Over the course of 2004/05, APRA will be releasing a series of discussion papers on the main implications of IFRS for the prudential framework in Australia, but no changes to current prudential treatments will be made before July 2005 at the earliest. In the case of the ADI sector, the changes will, where relevant, be made in conjunction with the introduction of the Basel II Framework.

APRA has been liaising with the Financial Reporting Council, the Australian Accounting Standards Board, the Australian Auditing and Assurance Standards Board and professional accounting bodies on a range of accounting and auditing-related matters to do with IFRS. APRA has also augmented its accounting and actuarial skills to better position it for the transition to IFRS.

Capitalised expenses

In December 2003, after public consultation, APRA revised the capital adequacy standard for ADIs by requiring them to treat certain types of capitalised expenses – such as loan origination fees and commissions paid to mortgage originators and brokers – as intangible assets for prudential purposes, and to deduct them from capital. An earlier survey by APRA had identified inconsistencies in the treatment of these items in prudential reporting. The revised standard, which came into effect from 1 July 2004, strengthens the capital adequacy framework for ADIs by enhancing confidence that assets are available to protect depositors should an ADI come under stress.

Home loan risk–weighting

In February 2004, APRA released a discussion paper proposing the introduction of more detailed criteria for ADIs to qualify for the concessional risk-weighting of residential mortgage lending for capital adequacy purposes. APRA's proposal followed its earlier survey of the experience of ADIs with 'low doc' loans, which are written with considerably less documentation and verification of income and serviceability than conventional mortgage lending, and which ADIs themselves consider carry a higher risk of loss. APRA also noted that, in some cases, ADIs are offering loans originated via mortgage brokers and other third party channels, without independently verifying relevant information about the borrowers.

For some time, APRA has allowed a 50 per cent risk-weighting for residential mortgage lending for capital adequacy purposes. This concession reflects the very low loss rates historically associated with mortgage lending in Australia. It also reflects the fact that conventional mortgage lending by ADIs has involved them undertaking a thorough assessment of the ability of the borrower to service the loan, verifying all material information related to the borrower and confirming the valuation and marketability of the property. APRA's concern is that applying the concessional risk-weight to loans where these procedures are not followed may not adequately reflect the likelihood of increased risk.

Under the revisions proposed by APRA, loans where ADIs do not verify the borrower's servicing ability would require a higher equity contribution by the borrower, or would need to be fully mortgage insured with an acceptable lenders mortgage insurer (LMI), before such loans qualify for the concessional risk-weight. APRA has consulted extensively with industry on these proposals and the revised prudential standards come into effect from 1 October 2004.

Lenders mortgage insurance

APRA's housing loan stress test confirmed that a significant proportion of ADI counterparty default risk for housing loans is transferred to LMIs. In late 2003, APRA extended the stress test to LMIs and conducted a broader review of the LMI industry including reinsurance arrangements, parental support, reporting requirements and relationships with ADIs. This review highlighted inadequacies in capital requirements and reporting to APRA, inconsistencies in prudential supervision of LMIs and ADIs and possibly ineffective risk transfer arrangements.

In response to this review, APRA released a discussion paper in August 2004 proposing an improved capital framework for LMIs. The core elements of the framework are a new, more risk-sensitive regulatory capital model and a significant increase in minimum regulatory capital requirements. APRA has also proposed a tightening of the prudential rules governing the 50 per cent risk-weighting available to ADIs on mortgage-insured loans.

Formal consultation with the industry will be followed by the release of draft prudential and reporting standards and guidance notes in late 2004, with a planned implementation date of July 2005.

Fit and Proper

The development of harmonised prudential standards took an important step when APRA, in March 2004, released for consultation proposed fit and proper prudential standards for 'responsible persons' of ADIs, general insurers and life insurers. (Fit and proper standards in superannuation were addressed in the superannuation reforms.) The standards would apply to directors, senior managers, auditors and (where relevant) actuaries of these institutions, and are intended to ensure that these persons have the competence and integrity necessary to perform their roles. APRA sees these standards as an essential element in ensuring the safety and stability of regulated institutions.

The draft standards put the onus on regulated institutions to develop formal policies that deal with the fitness and propriety of 'responsible persons', and propose minimum criteria to which a regulated institution must have regard. If a responsible person does not meet the standards, the employing institution would be expected to remove that person. APRA would intervene only when it has explicit concerns about an individual which have not been adequately addressed by the employer.

APRA received a number of submissions on these proposals and is consulting with respondents. Revised draft standards, taking into account comments received, are expected to be released for further consultation later in 2004.

Business continuity management

A draft prudential standard on business continuity management, applying to ADIs, general insurers and life insurance companies, was released in July 2004 for public consultation. The objective of the proposed standard is to ensure that regulated institutions are able to adequately manage business disruptions arising from internal and external events. A harmonised framework for business continuity risk management across the three APRA-regulated industries will reduce the potential for service disruption to customers and increase the level of protection provided to depositors and policyholders.

Discretionary Mutual Funds (DMFs) and Direct Offshore Foreign Insurers (DOFIs)

The HIH Royal Commission raised concerns about the provision of insurance products by DMFs and DOFIs outside APRA's regulatory reach. In response, the Government commissioned an inquiry (the Potts Review) to determine whether it is necessary and possible to provide the same level of protection to consumers (and third parties) of products supplied by DMFs and DOFIs as is currently provided to customers of authorised general insurers.

The Potts Review recommended that DMFs be required to offer discretionary mutual cover only as a contract of insurance under the *Insurance Act 1973*, unless APRA considers that a DMF is not carrying any contingent risk that would need to be met by additional undefined member contributions. DMFs that do not carry contingent risk would not be subject to prudential supervision. They would, however, be required to comply with an enhanced consumer protection framework requiring increased disclosure. With respect to DOFIs, the Potts Review recommended that DOFIs marketing insurance in Australia be exempt from APRA prudential regulation if they are domiciled in a country APRA considers to have comparable prudential regulation, subject to a market significance threshold to prevent established authorised insurers moving offshore. DOFIs not meeting this test would be able to market insurance in Australia as an authorised insurer, through a branch or subsidiary.

The Government has accepted these recommendations and APRA is currently working with the Treasury on their implementation.

Medical indemnity insurance reform

The Medical Indemnity (Prudential Supervision and Product Standards) Act 2003 (MI Act), which commenced from 1 July 2003, prohibits an institution from providing medical indemnity cover unless the institution is authorised under the *Insurance Act 1973*. APRA has consulted extensively with industry and interested parties to help ensure the smooth implementation of this legislation. Regulations have been issued to clarify the intent of the legislation and address some anomalies that have emerged.

The previous requirement under section 24 of the MI Act that APRA issue guidelines for determining whether premiums for certain types of medical indemnity cover were reasonable has been repealed. A new section 7A sets out matters that must be considered in determining whether premiums payable under a contract of insurance are reasonable.

In December 2003, the Medical Indemnity Policy Review Panel made a number of recommendations to strengthen the Government's reforms of medical indemnity insurance. APRA provided advice to the Panel, and it has subsequently assisted in the development of protocols between the Health Insurance Commission and medical indemnity insurers to give effect to the changes.

Under the MI Act, certain institutions providing medical indemnity cover have up to five years to comply with the minimum capital requirements imposed by prudential standards made under the *Insurance Act 1973*. Most of the medical indemnity insurers have availed themselves of these transitional arrangements and APRA is closely monitoring their progress against funding plans. All medical indemnity insurers have been required to prepare a Financial Condition Report, similar to that currently required by life insurers and proposed for general insurers in APRA's latest round of reforms.

Financial statistics

APRA collects financial statistics from a wide range of financial institutions, regulated and unregulated. Data on individual regulated entities are a vital input into risk assessments by APRA supervisors. Published aggregate data are important to market participants – whether senior management of financial institutions, market analysts or researchers – and to policymakers. APRA also collects extensive data on behalf of the Reserve Bank of Australia (RBA) and the Australian Bureau of Statistics (ABS). As the central repository of financial sector information in Australia, APRA has been seeking to reduce the complexity and cost to the finance sector of providing data and, over time, has been improving the quality and usefulness of these data.

APRA is currently revamping its suite of statistical publications to provide a wider range of more relevant information on APRA-regulated industries. The revised publications will provide regulated institutions with comparative data upon which to judge organisational performance, set competitive direction and assess both the relative exposure to risk and adequacy of management controls. The publications will provide greater industry transparency for market analysts and researchers and will provide a firmer foundation for public debate on policy issues. In designing the new statistical publications, APRA needs to balance the requirements of users against its own obligations to preserve the confidentiality of individual institution data. Over the coming year, APRA will consult on a number of statistical publications to ensure that the requirements of users and providers of data are fully considered.

This consultation process has already been completed in the case of superannuation entities and more detailed reporting requirements came into effect for the 2003/04 financial year. The first annual return is due by end October 2004. The new reporting framework will strengthen APRA's ability to supervise superannuation entities and will lead to material improvements in published data on the industry.

The provision of more relevant quantitative information has been made possible by APRA's program to modernise reporting requirements across the industries it regulates. APRA inherited six disparate reporting regimes from its predecessor agencies, but the financial statistics now collected are more closely aligned with accounting standards, prudential standards and the products and services offered by financial institutions. This ensures that these statistics are more relevant for prudential supervision and can be readily generated by the internal reporting systems of regulated institutions.

Managing the change from one reporting regime to another has been a large exercise for regulated institutions and APRA, requiring a significant investment of resources. Now that the majority of institutions have become more accustomed to the new statistical framework and are submitting more accurate data on time, APRA can realise and share the full benefits of the exercise with regulated institutions and industries.

5

APRA'S COSTS AND PERFORMANCE

APRA's expenditure is devoted, directly or indirectly, to enhancing and implementing the prudential framework in Australia and to prudential supervision and enforcement activities in relation to supervised 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 other measures are being developed by APRA to assess its overall performance as prudential supervisor.

FINANCIAL PERFORMANCE

APRA's expenditure

APRA's total operating expenditure in 2003/04 was $74.2 million. This included costs of $1.3 million in relation to the HIH Royal Commission, for which a separate appropriation was received in 2001/02, and costs of $1.4 million which are covered by additional revenue sources[1]. Excluding these amounts, operating expenditure was $71.5 million, compared with the original budget of $70.8 million.

The table below shows the trend in net operating expenditure on prudential regulation and in APRA staff levels over the past five years. The numbers have been adjusted for abnormal items.

Following integration of eleven predecessor supervisory agencies into a single regulator, which delivered significant savings in corporate functions, the running costs of prudential supervision have risen from 2001/02 onwards. This is a consequence of more intensive supervision activities, a rebuilding of APRA's supervisory staff levels and an active program to upgrade the prudential framework. This trend will continue in 2004/05.

Operating expenditure and staff trends as at 30 June 2004

	$ million	Average staffing level[2]
1999/00	52.8	397
2000/01	52.5	396
2001/02	55.8	407
2002/03	62.7	457
2003/04	71.5	496
2004/05 (budgeted)	81.6	545

1 APRA received an annual appropriation of $4 million in 2001/02 specifically for the costs of the HIH Royal Commission. Money from this appropriation has been spent over a number of years and will continue in 2004/05.

2 For 1999/00 and 2000/01, the figures are full-time equivalent staff at 30 June. Figures for subsequent years are average headcount over the year.

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 2003/04 is the separate appropriation of $1.3 million from the Government in relation to the HIH Royal Commission.

Levies are raised according to the *Financial Institutions Supervisory Levies Collection Act 1998* and six other Acts applying to the main industry sectors. Prior to the beginning of each financial year, the Minister announces the levy determinations 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 2003/04 were $86.1 million, compared with the plan of $85.4 million.

APRA's total revenue from ordinary activities in 2003/04 was $76.3 million. After adjusting for HIH Royal Commission funding and additional revenue to cover specific costs, net revenue was $73.3 million, compared with the original budget of $72.2 million.

Reserves

APRA had an operating surplus of $2.1 million in 2003/04, which increased accumulated surpluses to $5.4 million. However, this includes $2.1 million of an annual appropriation that will be returned to Government in accordance with the conditions under which it was appropriated[1]. The net reserves of $3.3 million were equivalent to 4.5 per cent of net levies appropriated to APRA, below the target range of five to ten per cent that had earlier been set by APRA's former Board.

1 APRA was appropriated $2.1 million as an annual appropriation in 2001/02 for superannuation and communication costs on the condition that the amount be recovered through industry supervisory levies.

BUSINESS PLANNING AND PERFORMANCE

The primary business outcome of APRA is to protect beneficiaries and to enhance public confidence in Australia's financial institutions through a framework of prudential regulation, which balances the objectives of financial safety and efficiency, competition, contestability and competitive neutrality. 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.

Three of the KRAs align with the APRA outputs of surveillance, policy development and prudential advice, which are described in the budget papers. Operating expenditure under the remaining three KRAs – resources, infrastructure and accountability – is allocated to these outputs. The estimated percentage distribution of APRA's operating expenditure across its main outputs in 2003/04 is shown below. The allocation of outputs is shown in Note 25 to the *Financial statements*.

supervision, rehabilitation and enforcement	82 per cent
development of prudential policies and standards	10 per cent
prudential advice	8 per cent

APRA has been developing measures that provide a general quantitative indicator of its supervisory performance. Two such measures are:

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

No prudential regulator can guarantee against failures of financial institutions. Rather, APRA strives to ensure that prudential failures are rare, small in terms of dollar losses and identified early enough so that appropriate wind-up or other exit strategies can be set in train. Since APRA's inception in 1998, the PER has averaged 99.95 per cent annually and the MPR, which is dominated by the losses associated with HIH, has averaged 99.91 per cent annually.

Other indicators of performance being developed by APRA include visit coverage of 'High' and 'Extreme' impact entities (as rated by PAIRS) and supervisory response times following on-site visits.

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

Financial year	Number of failures[1]	Losses ($million)	Number of institutions[2]	Protected Accounts[3] ($million)	Annual PER %	Annual MPR %
1999	3	10	4,473	887,172	99.93	99.99
2000	3	308	4,406	993,949	99.93	99.97
2001	3	5,338[4]	4,350	1,043,111	99.93	99.49
2002	0	0	3,803	1,009,533	100.00	100.00
2003	4	11	3,252	1,066,993	99.88	99.99
2004	0	0	2,745	1,209,600	100.00	100.00

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

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

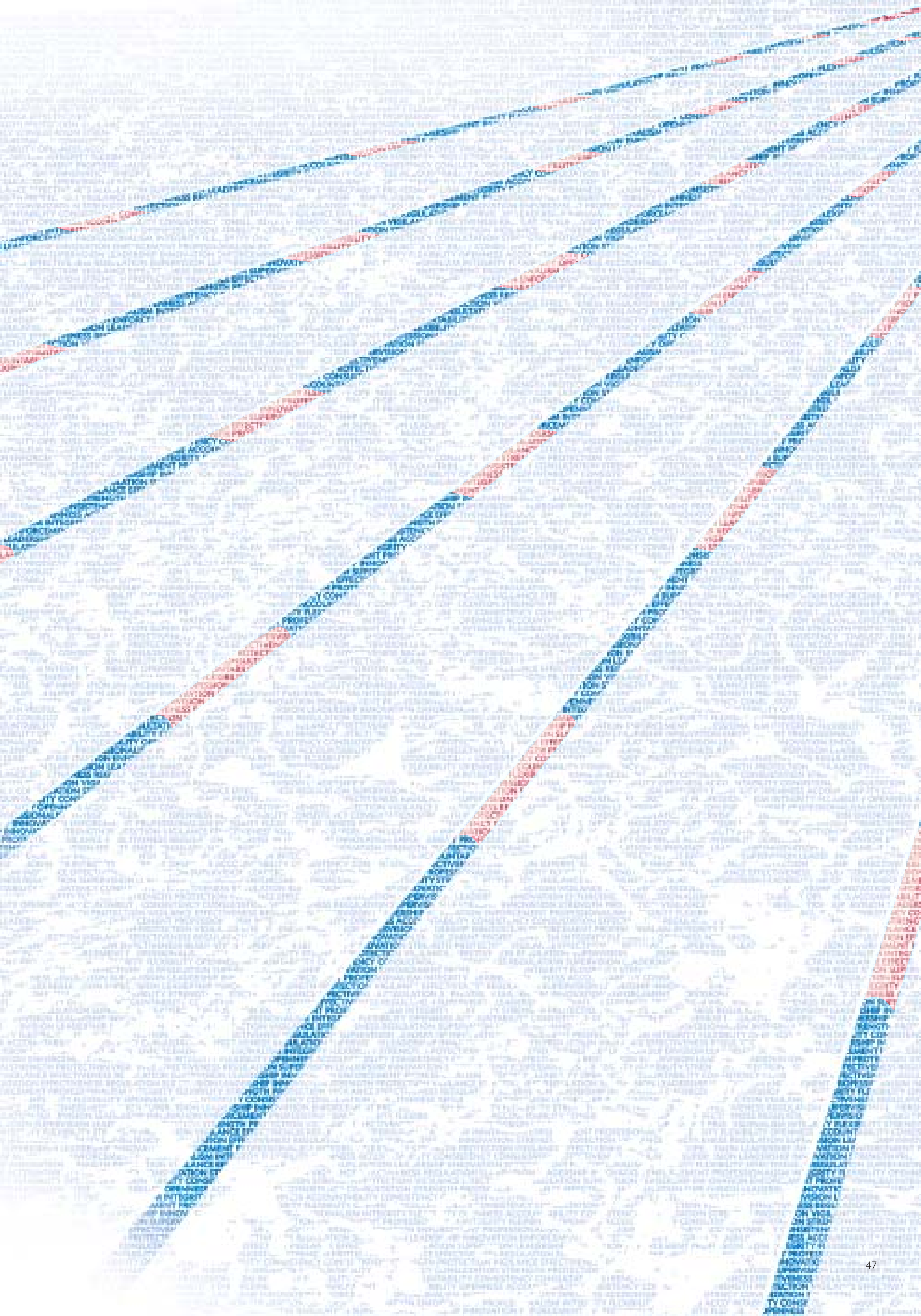
3 Protected Accounts is an estimate of the funds protected by APRA as defined by relevant legislation and is less than the total assets held by APRA-regulated institutions, which were $1,961 billion at end-June 2004.

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

6

COOPERATION AND LIAISON

APRA's effectiveness as a prudential regulator is strengthened by its close relationships with other regulatory agencies, both domestic and international, and regular liaison with relevant industry bodies and others with an interest in prudential matters. This network of cooperation and liaison promotes the sharing of information on financial sector developments and risks and helps to influence the evolution of the domestic and international regulatory frameworks. Global initiatives to harmonise prudential and accounting standards have added increasing weight to the importance of APRA's international network.



Australia

APRA is one of three independent statutory agencies with specific functional responsibilities in the Australian 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.

The coordinating body for these three agencies is the Council of Financial Regulators. The Council has no regulatory functions of its own, but operates as a high-level forum for sharing information and views and discussing regulatory issues. Following the change in APRA's governance arrangements, which ended the formal links between the three agencies at APRA Board level, the Council has been given an enhanced role and its membership has been broadened to include the Treasury. The Council's main focus is to ensure that there are appropriate arrangements between the members for coordinating their activities in response to pressures, and to advise the Government on the adequacy of Australia's financial system regulatory architecture in light of ongoing developments.

APRA also has close bilateral arrangements with the other members of the Council and meets regularly with them, under Memoranda of Understanding (MOU) it has entered into with each of these agencies. Regular dealings with the RBA are conducted through the RBA/APRA Coordination Committee; in 2003/04, major items for discussion were housing market developments and credit conditions more generally, crisis management arrangements and the sharing of statistics collected by APRA.

APRA and ASIC have different but complementary roles in relation to prudentially regulated institutions and they are firmly committed to a cooperative working relationship, full and timely exchange of information and a mutual understanding of their respective roles. The relationship has matured and strengthened over the year. In response to the recommendations of the HIH Royal Commission, the two agencies reviewed and took the opportunity to refresh their MOU, and the protocols which underpin day-to-day communications and exchanges are being reassessed. APRA and ASIC also worked together on a number of unit pricing issues which resulted in significant compensation being paid to customers (see page 26 of this Report), and they have been coordinating their involvement in other enforcement matters.

During the upcoming year, the two agencies will continue to cooperate on the few remaining tasks flowing from the Report of the HIH Royal Commission and on the implementation of international accounting standards in Australia.

APRA works closely with the Treasury in the development of the financial regulation framework and on associated legislative changes. The Government's reforms to superannuation involved detailed consultations between these two agencies during the year.

APRA also has extensive liaison with a range of official and industry bodies. Official bodies include the Financial Reporting Council, the Australian Accounting Standards Board and the Australian Auditing and Assurance Standards Board, where the particular focus of interest over the year was international accounting standards. Industry bodies include the Australian Bankers' Association, Credit Union Services Corporation (Australia) Limited, the National Credit Union Association, the Australian Association of Permanent Building Societies, the International Banks and Securities Association, the Australian Finance Conference, the

Investment and Financial Services Association, the Insurance Council of Australia and the Association of Superannuation Funds of Australia. APRA also speaks regularly with professional associations and institutes such as those for accountants, actuaries, auditors, directors, financial planners, managers and trustees. APRA's regional offices have wide-ranging liaison programs including with the regional offices of ASIC, industry bodies and professional associations.

International liaison

APRA is engaged in a range of global initiatives to strengthen the international financial regulatory architecture. It has also been stepping up 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.

This enhanced liaison effort is part of a general move by prudential regulators to improve information sharing so as to bolster the prudential oversight of internationally active financial services firms. It is also a specific response to the recommendation of the HIH Royal Commission that APRA take steps to ensure there is an effective exchange of information with overseas regulators on Australian insurers with international operations. During the year, APRA signed MOUs with the Reserve Bank of New Zealand and the Financial Services Authority of the United Kingdom, and it engaged in negotiations on MOUs with regulators in France, Germany, Hong Kong and the People's Republic of China.

The various international groups and forums in which APRA has been active in 2003/04 include:

- International Association of Insurance Supervisors (IAIS) – An APRA executive is chair of the IAIS Technical Committee, which has responsibility for the development of all IAIS principles, standards and guidance papers related to insurance regulation, before their approval by IAIS members. APRA is also active in the IAIS sub-committees for Accounting (work agenda includes international accounting standards, especially those applying to disclosure, financial instruments and insurance), Enhanced Disclosure (draft standard on technical performance and risks for non-life insurers and reinsurers), Financial Conglomerates (coordinates IAIS views on supervision of conglomerates for input to the Joint Forum and supports its work), Reinsurance (a standard on supervision of reinsurers was approved in October 2003) and Solvency (stress-testing, use of actuaries, appropriate forms of capital convergence of capital adequacy requirements, credit risk transfer and investment risk management). APRA participated in the IAIS Task Force on Revisions to the Insurance Core Principles and Methodology, and revised core principles were accepted by the IAIS in October 2003. APRA also provided input into the work of IAIS sub-committee for Insurance Fraud.
- 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 supervisors to discuss prudential issues. During 2003/04, the main topic of discussion by the CPLG was the Basel II Framework; other topics were the new international accounting standards and means of strengthening interaction with other bank supervisors and regional groups of supervisors.

APRA has been a major contributor to the work of the CPLG Working Group on Capital, which has provided advice and guidance on the development and implementation of the Basel II Framework. The Basel Committee has established the Accord Implementation Group (AIG) to address implementation issues. APRA is participating as a member of a working group providing advice to the AIG on a number of technical aspects of the more sophisticated approaches to credit risk provided for under the Basel II Framework. The AIG is also using case studies of a small number of large global banks to assist it in its work. Some of these banks have Australian-incorporated subsidiaries and APRA is assisting with one of the case studies.

APRA is also a member of the Basel Committee Electronic Banking Group, which is currently looking at a number of electronic banking issues including electronic security, IT outsourcing and e-finance developments.

- Joint Forum – Together with ASIC, APRA is a member of the Joint Forum, which brings together the IAIS, the Basel Committee and the International Organisation of Securities Regulators (IOSCO) to discuss cross–sectoral issues. During 2003/04, the Joint Forum examined economic capital models and the transfer of risk from banking to insurance sectors, and hosted a forum of global conglomerates on economic capital models.
- International Network of Pension Regulators (INPRS) – APRA is a member of the INPRS and is represented on its Technical Committee. Discussions at recent INPRS regional meetings have revolved around the different structures of pension systems, approaches to supervision and the need for information exchange about pension systems and reform issues. A number of countries within the Asia-Pacific region have been embarking on significant reform initiatives and have been keen to seek the views of OECD and INPRS members on aspects of the reform proposals, including areas such as system design, sustainability and supervision frameworks. A new body representing supervisors of private pension systems, the International Organisation of Pension Supervisors, was established in July 2004 at the instigation of the INPRS. APRA is a member of the IOPS Executive Committee. APRA also represents Australia at the bi-annual meeting of the Working Party on Private Pensions, which in 2003 finalised a Core Principles Methodology for Private Pensions and has been examining the funding position of defined benefit funds, benefit security and investment guidelines.
- International Actuarial Association (IAA) – Actuaries within APRA were actively involved in IAA work during 2003/04 either as Australian delegates to the IAA or participating in IAA committees for Insurance Regulation (which produced the discussion paper *A Global Framework for Insurer Solvency Assessment*, as well as input to various IAIS papers), Pensions and Employee Benefits (international accounting standard for employee benefits, including appropriate actuarial standards), Pensions, Benefits and Social Security (recently established to encourage information sharing and research into these issues from an actuarial perspective and with an APRA executive as vice-chair) and Professionalism (due process for development and adoption of standards, disciplinary processes for actuaries).

Integrated supervisory agencies from a number of countries, including APRA, meet annually to discuss the challenges and objectives of integrated supervision. At the sixth such conference, in August 2004, the issues considered included the legal powers of supervisors, funding arrangements, the role of specialists in supervisory agencies and the use of macro-economic surveillance for prudential purposes.

APRA also participates in a range of technical assistance initiatives in the region. While important to regional development and capacity building, this assistance is not a core function for an industry-funded prudential regulator and, where possible, APRA seeks funding from non-industry sources for such activities. Together with the RBA, APRA is a member of the Working Group on Banking Supervision of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), which brings together central banks and monetary authorities within the region. The Working Group provides a forum to discuss regional financial and prudential developments, including implementation of the Basel II Framework, and facilitates a number of training initiatives. APRA represents Australia as an observer to the Association of Financial Supervisors of Pacific Countries (AFSPC), formed through an initiative of the Pacific Central Bank Governors in late 2002. Among other things, this Association facilitates cooperation and information sharing, promotes capacity-building and adoption of international standards and practices, and gives an international voice to Pacific supervisors. APRA contributed speakers to an AFSPC course for Pacific supervisors in Sydney in April 2004 and subsequently conducted a 'master class' at APRA on operational risk management for more senior regional supervisors.

APRA is also involved in a number of other regional groupings that have programs to assist financial supervisors in the region. Programs include conferences, workshops and training, such as the Financial Regulators Training Initiative, a joint initiative of APEC, AusAid and the Asian Development Bank. Over 2003/04, this Initiative delivered one national and three regional training programs. To supplement this Initiative, the Australian APEC Study Centre is expanding its range of programs to cover banking, insurance and pension supervision. APEC also has a Bank Supervisors Advisory Group on which APRA is represented. Other training initiatives include those conducted through the Financial Stability Institute and the South-East Asian Central Banks (SEACEN) and South-East Asia New Zealand Australia (SEANZA) forums, for which APRA provides presenters and/or delegates.

Over 2003/04, APRA hosted over 60 international delegations, more than double the number in the previous year. Visitors were from OECD and regional regulatory agencies, international and regional organisations, government and government agencies, industry bodies and private sector organisations. Visitors from developing countries predominated. APRA also accepted staff from regional regulatory agencies on short-term secondment.

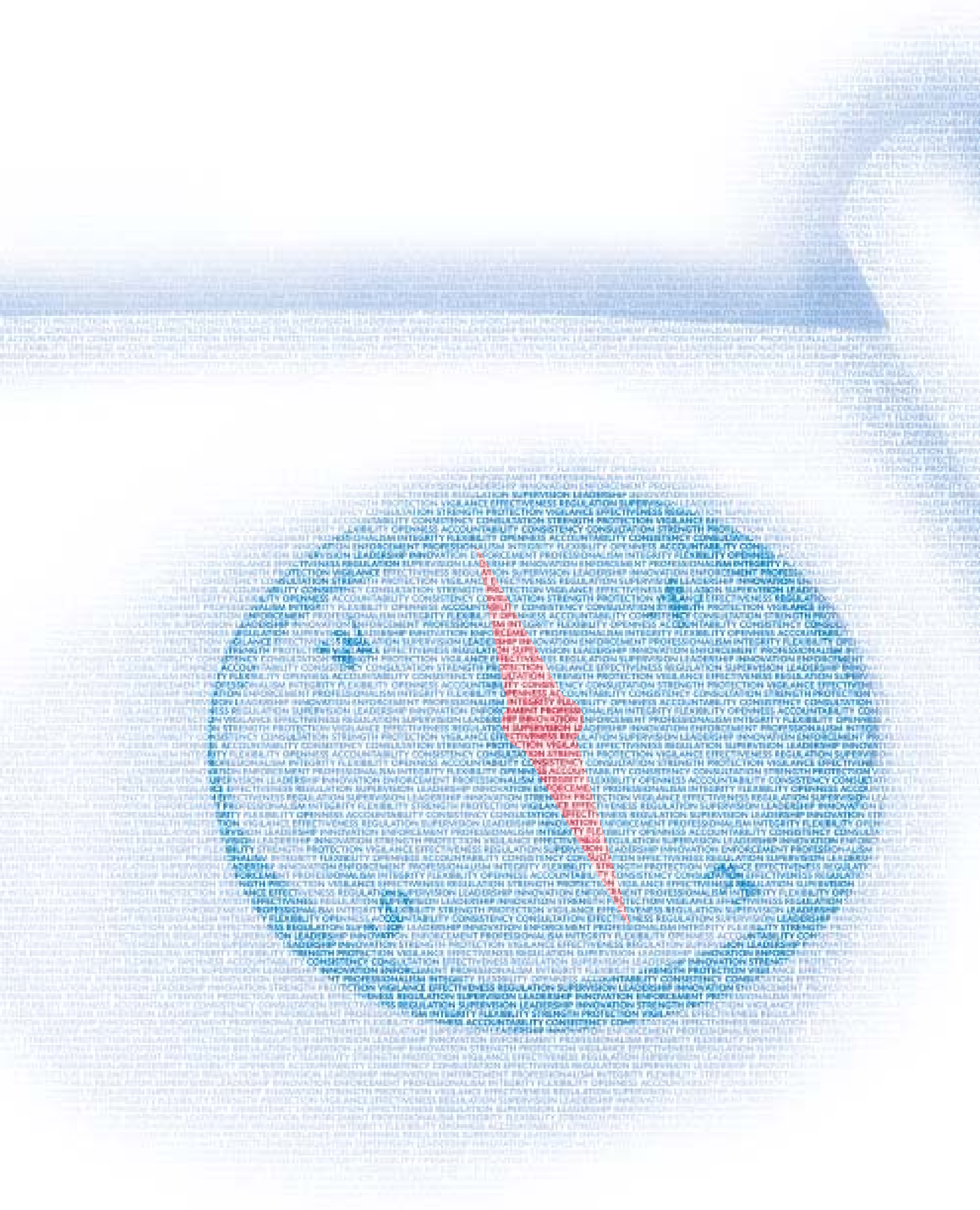
7

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).

Governance structure

The new governance structure comprises a full-time Executive Group of at least three and no more than five members. The Executive Group is responsible and accountable for the operation and performance of APRA. This structure replaced the governance arrangements that had been in place since APRA's establishment, which involved an executive Board, including ex officio members, and a Chief Executive Officer.



The amendments to the APRA Act 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 required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

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

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

Risk Management and Audit Committee

The Executive Group has established a new Risk Management and Audit Committee to replace the previous committee, which was made up of APRA Board members. The Charter of the Committee was also revised in line with 'best practice' developments in this area.

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

During 2003/04, the members of the Committee were:

Ms Elizabeth Alexander AM
Chair
B.Com (Melb), FCA, FCPA, FAICD

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

Members' attendance at Executive Group meetings from 1 July 2003 to 30 June 2004

	Meetings	Attended
John Laker	20	20
Ross Jones	20	20
Steve Somogyi [1]	20	17

1 Assumed duties in September 2003.

Mr Norbury Rogers AO
External Member
BCom (Qld), AAUQ, FCA, FAICD

Mr Norbury Rogers, who has been appointed for a five-year term, is a Chartered Accountant and Company Director and is a senior consultant to Ernst and Young, having spent many years as its Managing Partner and Senior Partner. Mr Rogers has a portfolio of directorships including Chairman of Golden Casket Lottery Corporation Limited, the Australian Institute of Marine Science (AIMS) and UniQuest Pty Limited. He is a non-executive director of Magellan Petroleum Australia Ltd.

Mr Steve Somogyi
APRA Member

Mr Charles Littrell
Executive General Manager – Policy, Research and Statistics

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 senior management to identify and address risks facing APRA by providing them and APRA's Risk Management and Audit Committee with summaries of high and significant risks at organisational and divisional levels. Risk management strategies to mitigate these risks are also documented as part of the organisation's risk profile. Risks are re-assessed on a regular and planned basis.

Risk assessment and internal audit staff utilise an ongoing process consistent with the Australia/New Zealand Standard on Risk Management (AS/NZS 4360:1999). Regular risk profile and audit reports to senior management and the Risk Management and Audit Committee provide 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 Executive Group 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 2003/2004 Strategic Internal Audit Plan. There were no incidents of fraud reported for the year.

Following an independent review of APRA's risk management and internal audit function, which had been provided on an outsourced basis, the Executive Group approved a recommendation of the Risk Management and Audit Committee to bring this function in-house. A new General Manager – Risk Assessment and Internal Audit was appointed in June 2004.

Attendance at Risk Management and Audit Committee meetings from 1 July 2003 to 30 June 2004

	Meetings	Attended
Elizabeth Alexander	5	5
Norbury Rogers	5	4
Steve Somogyi	5	5
Charles Littrell	5	3

APRA Members

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

Mr (Kerry) Ross Jones
Deputy Chairman and APRA 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
APRA 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 CPI Group Limited.

8

FINANCIAL STATEMENTS

Statement by Members

In our opinion, the attached financial statements for the year ended 30 June 2004 are based on properly maintained financial records and give a true and fair view of the matters required by the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*.

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

Dr John F. Laker Chairman 20 August 2004	Mr K. Ross Jones Deputy Chairman 20 August 2004	Mr Steve Somogyi Member 20 August 2004

Statement of Financial Performance for the year ended 30 June 2004

	Note	2004 $'000	2003 $'000
Revenue			
Revenues from ordinary activities			
Revenue from Government	6A	**70,309**	61,152
Goods and services	6B	**2,345**	1,702
Interest	6C	**1,731**	1,114
Revenue from sale of assets	6D	**9**	1
Rental recoveries		**970**	1,084
Licence fees and other charges	6E	**411**	120
Insurance recoveries and other revenue	6F	**523**	3,283
Revenues from ordinary activities		**76,298**	68,456
Expenses			
Expenses from ordinary activities			
Employees	7A	**46,918**	40,951
Suppliers	7B	**23,054**	23,995
Depreciation and amortisation	7C	**3,956**	3,489
Write-down of assets	7D	**275**	4
Value of assets sold	7E	**28**	185
Expenses from ordinary activities		**74,231**	68,624
Operating surplus (deficit) from ordinary activities	12	**2,067**	(168)
Total changes in equity other than those resulting from transactions with the Australian Government as owner		**2,067**	(168)

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

Statement of Financial Position as at 30 June 2004

	Note	2004 $'000	2003 $'000
Assets			
Financial assets			
Cash	8A	**18,633**	10,815
Receivables	8B	**3,079**	5,162
Total financial assets		**21,712**	15,977
Non-financial assets			
Infrastructure, plant and equipment	9A,C	**4,073**	5,542
Intangibles	9B,C	**5,392**	6,540
Other non-financial assets	9D	**581**	294
Total non-financial assets		**10,046**	12,376
Total assets		**31,758**	28,353
Liabilities			
Payables			
Suppliers	10A	**4,600**	2,970
Other payables	10B	**65**	14
Revenue in advance	10C	**1,061**	2,000
Total payables		**5,726**	4,984
Provisions			
Employees	11A	**13,072**	12,280
Other provisions	11B	**1,907**	1,998
Total provisions		**14,979**	14,278
Total liabilities		**20,705**	19,262
Net assets		**11,053**	9,091
Equity			
Contributed equity	12	**5,255**	5,255
Reserves	12	**382**	487
Accumulated surpluses	12	**5,416**	3,349
Total equity	12	**11,053**	9,091
Current assets		**22,293**	16,271
Non-current assets		**9,465**	12,082
Current liabilities		**13,420**	12,842
Non-current liabilities		**7,285**	6,420

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

Statement of Cash Flows for the year ended 30 June 2004

	Note	2004 $'000	2003 $'000
Operating activities			
Cash received			
Revenue from Government		**70,630**	59,875
Goods and services		**2,169**	1,431
Interest		**1,699**	1,122
Rental recoveries		**746**	1,084
Licence fees and other charges		**411**	120
Insurance recoveries and other revenue		**523**	2,682
GST recovered from ATO		**1,626**	2,165
Total cash received		**77,804**	68,479
Cash used			
Employees		**(44,499)**	(39,135)
Suppliers		**(23,855)**	(26,185)
Total cash used		**(68,354)**	(65,320)
Net cash from operating activities	13	**9,450**	3,159
Investing activities			
Cash received			
Proceeds from sale of plant and equipment		**9**	1
Total cash received		**9**	1
Cash used			
Purchase of plant and equipment		**(749)**	(1,260)
Purchase of intangibles		**(892)**	(1,501)
Total cash used		**(1,641)**	(2,761)
Net cash used by investing activities		**(1,632)**	(2,760)
Financing activities			
Cash used			
Net cash used by financing activities		–	–
Net increase/(decrease) in cash held		**7,818**	399
Cash at the beginning of the reporting period		**10,815**	10,416
Cash at the end of the reporting period	8A	**18,633**	10,815

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

Schedule of Commitments as at 30 June 2004

	Note	2004 $'000	2003 $'000
By type[1,2]			
Commitments payable			
Operating leases		**18,060**	25,142
Total commitments payable		**18,060**	25,142
Commitments receivable			
Operating sub-leases[3]		**(1,559)**	(3,475)
Total commitments receivable		**(1,559)**	(3,475)
Net commitments		**16,501**	21,667
By maturity			
Commitments payable			
One year or less		**5,644**	6,101
From one to five years		**12,416**	18,340
Over five years		**–**	701
Total commitments payable		**18,060**	25,142
Commitments receivable			
One year or less		**(506)**	(1,226)
From one to five years		**(1,053)**	(2,249)
Total commitments receivable		**(1,559)**	(3,475)
Net commitments		**16,501**	21,667

Operating leases are non-cancellable and comprise:

Nature of lease	General description of leasing arrangement
Leases for office accommodation	Lease payments are subject to annual review to prevailing market rates. Office leases are current for space in Sydney, Canberra, Melbourne, Adelaide, Brisbane and Perth with some of the Sydney leases and the Perth, Melbourne and Brisbane leases due for review and renewal in 2004/05.
Leases of office equipment – photocopiers	Lease payments are set for the period of the lease. APRA does not have the option to purchase the asset at the conclusion of the lease period.

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

1 Commitments are GST inclusive where relevant.
2 APRA has no capital commitments.
3 Operating sub-leases commitments receivable comprise amounts receivable from other bodies for sub-leasing of office accommodation.

Schedule of Contingencies as at 30 June 2004

	Note	2004 $'000	2003 $'000
Contingent liabilities			
Claims for damages/costs	14(a)	**(800)**	–
Total contingent liabilities		**(800)**	–
Contingent assets			
Legal claims	14(b)	**26**	–
Total contingent assets		**26**	–
Net contingent assets/(liabilities)		**(774)**	–

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

Schedule of Administered Items

	Note	2004 $'000	2003 $'000
Revenues administered on behalf of Government			
for the year ended 30 June			
Taxation revenue			
Financial institutions supervisory levies	21A	**58,676**	79,444
Financial Assistance Levy	21A	**7,616**	–
Total taxation revenue		**66,292**	79,444
Non–taxation revenue			
Enforcement penalty	21A	**1,000**	–
Total revenues administered on behalf of Government		**67,292**	79,444
Expenses administered on behalf of Government			
for the year ended 30 June			
Supervisory levy waivers and write-offs	21B	**780**	379
Financial Assistance Levy write-offs	21B	**6**	–
Total expenses administered on behalf of Government		**786**	379
Assets administered on behalf of Government			
as at 30 June			
Financial assets			
Cash	21C	**–**	1,930
Receivables – supervisory levies	21C	**90**	209
Receivables – Financial Assistance Levy	21C	**14**	–
Accrued revenue	21C	**–**	20
Total assets administered on behalf of Government		**104**	2,159
Liabilities administered on behalf of Government			
as at 30 June			
Total liabilities administered on behalf of Government		**–**	–

Schedule of Administered Items (continued)

Administered cash flows

for the year ended 30 June

	Note	2004 $'000	2003 $'000
Operating activities			
Cash received			
Financial institutions supervisory levies		**58,860**	78,982
Financial Assistance Levy		**7,596**	–
Enforcement penalty collected		**1,000**	–
Cash received from Official Public Account for refunds		**825**	231
Total cash received		**68,281**	79,213
Cash used			
Cash transferred to Official Public Account		**(69,386)**	(77,052)
Refunds of overpayment of levies		**(825)**	(231)
Total cash used		**(70,211)**	(77,283)
Net cash from operating activities		**(1,930)**	1,930
Cash at the beginning of the reporting period		**1,930**	–
Cash at the end of the reporting period		**–**	1,930

APRA administers the collection of financial institutions supervisory levies and Financial Assistance Levy on behalf of the Government. While the revenues from supervisory levies are in part used to fund the operations of APRA, they are not directly available to be used by APRA for its own purposes. All administered collections are remitted to the Government's Official Public Account (see Note 1.21). Transactions and balances relating to levies are reported in Note 21 as *Administered Items*.

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

Notes to and Forming Part of the Financial Statements

for the year ended 30 June 2004

Note	Description
1	Summary of significant accounting policies
2	Adoption of Australian Equivalents to International Financial Reporting Standards for year ends commencing on or after 1 January 2005
3	Economic dependency
4	Events occurring after reporting date
5	Special Appropriation for levies
6	Operating revenues
7	Operating expenses
8	Financial assets
9	Non-financial assets
10	Payables
11	Provisions
12	Equity
13	Cash flow reconciliation
14	Contingent liabilities and assets
15	Remuneration of APRA Members
16	Related party disclosures
17	Remuneration of officers
18	Remuneration of auditors
19	Average staffing levels
20	Financial instruments
21	Administered items
22	Appropriations
23	Assets held in trust
24	Special account
25	Reporting of outcomes

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 1. Summary of significant accounting policies

1.1 Basis of accounting

(a) General

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 2004) Orders*;
- Australian Accounting Standards and Accounting Interpretations issued by the Australian Accounting Standards Board; and
- Consensus Views of the Urgent Issues Group.

(b) Authority items

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* (other than unquantifiable or remote contingencies, which are reported at Note 14(c)).

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.

(c) 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 1.21.

1.2 Changes in accounting policy

The accounting policies used in the preparation of these financial statements are consistent with those used in 2002/03, except as indicated below.

In 2003/04, the initial revaluation of infrastructure, plant and equipment on a fair value basis was carried out, the effect of which is explained at Note 1.13(b).

In 2002/03, the Finance Minister's Orders introduced an impairment test for non-current assets, which were carried at cost and not subject to AAS10 – Recoverable Amount of Non-Current Assets. In 2003/04, $nil (2002/03: $nil) software was written-down under this policy.

In 2003/04, the impairment test provisions of the FMOs have been extended to cover non-current assets carried at deprival value. There were no assets in this category at 30 June 2004.

1.2 Changes in accounting policy (continued)

Certain administrative expenses, which were previously shown as Employee expenses, have been re-classified to Suppliers expense to more accurately reflect the nature of the expenses. Had this adjustment been made in 2002/03 the effect would have been to reduce Employee expenses by $1,456,000 to $39,495,000 and increase Suppliers expense by the same amount to $25,451,000.

1.3 Revenue

(a) Revenues from Government - appropriations

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

The full amount of appropriations for departmental (Authority) 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.

(b) Revenue from other sources

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

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.

Revenue from the issue of licenses to financial institutions and superannuation trustees, and license fees for local representative offices of foreign banks, is recognised on receipt of the application and license fee from the applicant.

Revenue from sub-lease rentals is recognised on issue of an invoice to the lessee.

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 recognised as insurance recoveries represents the amounts receivable from the liability insurer for costs that APRA had incurred in preparing submissions for the HIH Royal Commission, some of which were the subject of additional independent assessment, resulting in delayed settlement. Expenditure related to the HIH Royal Commission is represented under Suppliers expenses.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 1. Summary of significant accounting policies (continued)

1.3 Revenue (continued)

(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 2003/04 (2002/03: $nil).

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 (see also Note 12).

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

The leave liabilities are calculated on the basis of employees' remuneration, including the Authority's employer superannuation contribution, 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.

(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.

1.5 Employee benefits (continued)

(d) Superannuation

Certain employees of APRA are members of the Commonwealth Superannuation Scheme and the Public Sector Superannuation Scheme. The liability for these defined benefit superannuation schemes is recognised in the financial statements of the Australian Government and is settled by the Government in due course. APRA makes employer contributions to the Australian Government at rates determined by an actuary to be sufficient to meet the cost to the Government of the superannuation entitlements of APRA's employees.

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

For all other employees, employer contributions are made to other superannuation funds, as nominated by the employee (see Note 7A).

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. As at 30 June 2004, there were no finance leases current (2003: $nil).

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.

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 2003/04 (2002/03: $nil).

1.8 Cash

Cash means notes and coins held and any deposits held at call with a bank or financial institution. Cash is recognised at its nominal amount. Interest is credited to revenue as it accrues.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 1. Summary of significant accounting policies (continued)

1.9 Appropriations receivable

These receivables are recognised at the amounts due as calculated under section 50 of the APRA Act (refer Note 1.3(a)) less any provision made for doubtful levy debts.

1.10 Financial instruments

Accounting policies in relation to financial instruments are stated at Note 20.

1.11 Financial liabilities

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

1.12 Acquisition of assets

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

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. In 2003/04 assets with a fair value of $nil (2002/03: $nil) were acquired for nominal consideration.

1.13 Property (infrastructure), plant and equipment

(a) Asset recognition threshold

Purchases of infrastructure, plant and equipment are recognised initially at cost, 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 2001 were done on a deprival basis; revaluations since that date are at fair value, the first of these revaluations being as at 30 June 2004. This change in accounting policy is required by Australian Accounting Standard AASB1041 – Revaluation of Non-Current Assets. Valuations undertaken in any year are as at 30 June.

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

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

1.13 Property (infrastructure), plant and equipment (continued)

Under both deprival and fair value, assets which are surplus to requirements are measured at their net realisable value. At 30 June 2004, APRA held no surplus assets (30 June 2003: $nil).

The financial effect of this change in policy relates to those assets recognised at fair value for the first time in the current period where the measurement basis for fair value is different to that previously used for deprival value. The financial effect of the change is given by the difference between the fair values obtained for these assets in the current period and the deprival-based values recognised at the end of the previous period. The financial effect by class is as follows:

Asset class	Increment/(decrement) to asset class ($'000)	Contra account
Leasehold improvements	2004: $(274) 2003: $nil	Current year result
Leasehold improvements	2004: $(22) 2003: $nil	Revaluation reserve
Computer hardware and office equipment	2004: $(1) 2003: $nil	Current year result
Computer hardware and office equipment	2004: $(83) 2003: $nil	Revaluation reserve

Total financial effect was to decrease the carrying amount of infrastructure, plant and equipment by $380,000 (2003: $nil), decrease asset revaluation reserves by $105,000 (2003: $nil) and decrease current year results by $275,000 (2003: $nil).

(c) Frequency

Commencing with 2003/04 all infrastructure, plant and equipment and leasehold improvements assets were revalued to fair value.

The FMOs require that all infrastructure, plant and equipment assets be measured at up-to-date fair values from 30 June 2005 onwards. It is proposed to maintain annual revaluations on all fixed assets.

(d) Conduct

All valuations are conducted by an independent qualified valuer.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 1. Summary of significant accounting policies (continued)

1.13 Property (infrastructure), plant and equipment (continued)

(e) Depreciation and amortisation

Depreciable computer hardware and office equipment assets are written-down 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:

	2004	2003
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 7C.

1.14 Impairment of non-current assets

Non-current assets carried at up-to-date fair value at the reporting date are not subject to impairment testing.

The non-current assets carried at cost or deprival value, which are not held to generate net cash inflows, have been assessed for indications of impairment. Where indications of impairment exist, the carrying amount of the asset is compared to the net selling price and depreciated replacement cost and is written down to the higher of the two amounts, if necessary.

1.15 Intangibles

APRA's intangibles comprise internally developed software and purchased software for internal use. The assets are carried at cost. Items costing less than $3,000 are expensed in the year of acquisition.

Internally developed and purchased software assets are amortised on a straight-line basis over their anticipated useful lives. The useful lives of APRA software is the lesser of five years or assessed useful life (2003: Lesser of five years or assessed useful life).

All software assets were assessed for indications of impairment as at 30 June 2004 and none was found to be impaired.

1.16 Taxation

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

Revenues, expenses and assets are recognised net of GST:

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

1.17 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.

1.18 Insurance

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

1.19 Comparative figures

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

1.20 Rounding

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

- *Remuneration of APRA Members* (Note 15) and *Remuneration of officers* (Note 17); and
- *Remuneration of auditors* (Note 18).

1.21 Reporting of administered activities

(a) General

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

As indicated in Note 1.1, administered revenues, expenses, assets, liabilities and cash flows are disclosed in the *Schedule of Administered Items* and related notes.

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

(b) Administered cash transfers to and from Official Public Account

Levy revenue collections are initially paid into an administered receipts account maintained by the Authority and then transferred to the Official Public Account (OPA) maintained by the Department of Finance and Administration. In turn, where levy amounts are overpaid, the Department transfers money from the OPA into an administered payments account maintained by the Authority for the issue of refunds to the relevant entities that have made overpayments. These transfers to and from the OPA are adjustments to the administered cash held by the Authority on behalf of the Government and reported as such in the Statement of Cash Flows in the *Schedule of Administered Items* and in the administered reconciliation table in Note 21D. Thus the *Schedule of Administered Items* largely reflects the Government's transactions, through the Authority, with parties outside the Government.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 1. Summary of significant accounting policies (continued)

1.21 Reporting of administered activities (continued)

(c) Revenue

All administered revenues are revenues relating to the core operating activities performed by the Authority on behalf of the Government.

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

(d) Expenses

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

Waivers of levies under the *Financial Institutions Supervisory Levies Collection Act 1998* are shown at Note 21B, as required by the FMOs. Waivers generally occur due to a change of status of a supervised entity during the year, resulting in the annual levy being wholly or partly waived.

Note 2. Adoption of Australian Equivalents to International Financial Reporting Standards for year ends commencing on or after 1 January 2005

2.1 Background

The Australian Accounting Standards Board (AASB) has issued replacement Australian Accounting Standards to apply for year ends commencing on or after 1 January 2005. The new standards are the Australian Equivalents to International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board. The AASB have advised that early adoption of the new standards will not be allowed. The standards being replaced are to be withdrawn for year ends commencing on or after 1 January 2005, but will continue to apply until that time.

The purpose of issuing Australian Equivalents to IFRSs is to enable Australian entities reporting under the *Corporations Act 2001* to access capital markets more readily by preparing their financial reports in accordance with accounting standards that are recognised worldwide.

For-profit entities complying fully with the Australian Equivalents will be able to make an explicit and unreserved statement of compliance with IFRSs as well as with the Australian Equivalents.

It is expected that the Finance Minister will continue to require compliance with the Accounting Standards issued by the AASB, and the Australian Equivalents of IFRSs, in his Orders regulating the preparation of Authorities' financial statements for year ends commencing on or after 1 January 2005.

The Australian Equivalents contain certain additional provisions which will apply to not-for-profit entities, including APRA. Some of these provisions are in conflict with the IFRSs and therefore APRA will only be able to assert compliance with the Australian Equivalents to IFRSs and not the IFRS.

2.1 Background (continued)

Existing AASB standards that have no IFRS equivalent will continue to apply.

Accounting Standard AASB 1047 – Disclosing the Impact of Adopting Australian Equivalents to IFRSs, requires that the financial statements for 2003/04 disclose:

- an explanation of how the transition to the Australian Equivalents is being managed; and
- a narrative explanation of the key differences in accounting policies arising from the transition to the Australian Equivalents.

The purpose of this Note is to record these disclosures.

2.2 Management of the transition to Australian Equivalents to IFRSs

APRA has taken the following steps in preparation for the implementation of Australian Equivalents:

- the Authority has developed a staged implementation programme;
- APRA's Risk Management and Audit Committee will oversee the transition to and implementation of the Australian Equivalents to IFRSs. The Chief Financial Officer is formally responsible for the project and reports regularly to the Risk Management and Audit Committee against the implementation plan;
- the plan includes the following key steps:
    - identification of all major accounting policy differences between current AASB standards and the Australian Equivalents to IFRSs;
    - identification of systems changes necessary to enable reporting under the Australian Equivalents, including the capture of data under both sets of rules for 2004/05, and the testing and implementation of those changes;
    - preparation of a transitional balance sheet as at 1 July 2004, capturing the changes necessitated by compliance with Australian Equivalents. The revised balance sheet to be available for audit within two months of 30 June 2004;
    - preparation of an Australian Equivalent compliant balance sheet at the same time as the 30 June 2005 statements are prepared; and
    - meeting reporting deadlines set by Department of Finance and Administration for 2005/06 for the financial statements under Australian Equivalents of IFRS.
- the risks to successful achievement of the above objectives have been addressed and strategies have been devised to keep implementation on track to meet proposed deadlines; and
- to date, all major accounting and disclosure differences and system changes have been identified and the system changes required are insignificant. These changes were implemented by 15 August 2004.

2.3 Major changes in accounting policy

Changes in accounting policies under Australian Equivalents are applied retrospectively as if the new policy had always applied. This rule means that a balance sheet must be prepared under the Australian Equivalents as at 1 July 2004, except as permitted in particular circumstances by AASB 1 – First Time Adoption of Australian Equivalents to International Financial Reporting Standards. This revised balance sheet will enable the 2005/06 financial statements to report comparatives which are fully compliant with the Australian Equivalents.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 2. Adoption of Australian Equivalents to International Financial Reporting Standards for year ends commencing on or after 1 January 2005 (continued)

2.3 Major changes in accounting policy (continued)

Changes to major accounting policies are discussed in the following paragraphs.

(a) Property (infrastructure) plant and equipment

It is expected that the Finance Minister's Orders will require property (infrastructure) plant and equipment assets carried at valuation in 2003/04 to be measured at up-to-date fair value with effect from 2005/06. As all APRA infrastructure plant and equipment assets were revalued to fair value as at 30 June 2004, the impact, if any, of the adoption of the fair value method of valuation as at 30 June 2005 is expected to be minimal.

The transitional provisions of AASB 1 require that values at which assets are carried as at 30 June 2004 under existing standards will stand in the transitional balance sheet as at 1 July 2004.

Where applicable, borrowing costs related to qualifying assets are currently capitalised. It is understood that the FMOs for 2005/06 will elect to expense all borrowing costs under the new Australian Equivalent standard. Accordingly, any borrowing costs capitalised as at 1 July 2004 will be written-off to accumulated results.

(b) Intangible assets

APRA currently recognises internally developed software assets on the cost basis. This policy is in line with the requirements of the Australian Equivalent standard on intangibles.

(c) Impairment of non-current assets

APRA's policy on impairment of non-current assets is reported at Note 1.14.

Under the new Australian Equivalent standard, these assets will be subject to an annual assessment for impairment and, if there are indications of impairment, such impairment must be subjected to measurement (impairment measurement must also be done, irrespective of any indications of impairment, for intangible assets not yet available for use). The impairment test is that the carrying amount of an asset must not exceed the greater of (a) its fair value less cost to sell and (b) its value in use. 'Value in use' is the net present value of net cash inflows for for-profit assets of the Authority and depreciated replacement cost for other assets, which would be replaced if APRA were deprived of them.

(d) Employee benefits

The provision for long service leave is measured at the present value of estimated future cash outflows using market yields available for national government bonds as at the reporting date.

Under the new Australian Equivalent standard, the same discount rate will be used unless there is a deep market in high quality corporate bonds, in which case the market yield on such bonds must be used.

(e) Financial instruments

Financial assets and liabilities are likely to be accounted for as 'held at fair value through profit and loss' or available-for-sale where fair value can be reliably measured (in which case, changes in value are initially taken to equity). Fair values will be the published prices where an active market exists or by appraisal where this is not the case.

Cash and receivables are expected to continue to be measured at cost.

Financial assets, except those classified as 'held at fair value through profit and loss', will be subject to impairment testing.

	2004 $'000	2003 $'000

Note 3. 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 supervises (see Note 1.3).

Note 4. Events occurring after reporting date

No events occurring after balance date were noted.

Note 5. Calculation of APRA Special Appropriation

The APRA Special Appropriation is calculated in accordance with the provisions of section 50 of the APRA Act as outlined at Note 1.3(a). Details are as follows:

	2004 $'000	2003 $'000
Table 1: Summary		
Current year levies and penalties (see note 21A, Table 1)	**86,868**	74,733
Less: Waivers and write-offs (see Note 21B)	**(780)**	(379)
Net current year levies and penalties (see Table 2 below)	**86,088**	74,354
Less: Amounts retained in the CRF (see Table 3 below)	**(16,803)**	(14,668)
Total APRA Special Appropriation (see Table 4 below)	**69,285**	59,686
Table 2: Net current year levies and penalties by levy type		
Superannuation funds	**35,698**	30,286
Authorised deposit-taking institutions	**27,602**	23,753
Life insurers and friendly societies	**9,658**	8,983
General insurers	**13,016**	11,258
Retirement savings account providers	**114**	74
Total net current year levies and penalties	**86,088**	74,354
Table 3: Amounts retained in the CRF by levy type[4]		
Superannuation funds	**(10,483)**	(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 amount retained in CRF	**(16,803)**	(14,668)
Table 4: Equivalent amounts of levy payable to APRA under the APRA Special Appropriation by levy type		
Superannuation funds	**25,215**	21,938
Authorised deposit-taking institutions	**25,042**	21,193
Life insurers and friendly societies	**7,618**	6,943
General insurers	**11,296**	9,538
Retirement saving account providers	**114**	74
Total APRA Special Appropriation	**69,285**	59,686

4 As determined by the Treasurer in accordance with sub-section 50(1) of the *Australian Prudential Regulation Authority Act 1998.*

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

	2004 $'000	2003 $'000
Note 6. Operating revenues		
Note 6A. Revenues from Government		
Special Appropriation (see Note 5)	**69,285**	59,686
Annual Appropriation 2001/02 brought forward	**2,000**	966
Annual Appropriation 2001/02 re-issued[5]	**–**	2,500
Unearned Annual Appropriation (see Note 10C)	**(976)**	(2,000)
Total revenues from Government	**70,309**	61,152
Note 6B. Sales of goods and services		
Goods	**–**	–
Fees for service	**637**	662
Development of capital adequacy model for ADIs (Basel II)	**1,500**	1,000
Miscellaneous other services	**208**	40
Total sales of goods and services	**2,345**	1,702
Rendering of services to:		
Related entities	**550**	535
External entities	**1,795**	1,167
Total rendering of goods and services	**2,345**	1,702
Note 6C. Interest revenue		
Deposits at bank	**686**	537
Commonwealth and State Government securities	**1,045**	577
Total interest revenue	**1,731**	1,114

5 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 during 2002/03 for ongoing costs associated with the implementation of the recommendations of the HIH Royal Commission. At 30 June 2003, $2 million remained unspent and it was carried forward into 2003/04. At 30 June 2004 $976,000 of the appropriation remained unspent and was recorded as unearned annual appropriation, to be carried forward to 2004/05.

	2004 $'000	2003 $'000

Note 6D. Net gain/(loss) from disposal of assets

Infrastructure, plant and equipment		
Proceeds from disposal	**9**	1
Net book value of assets disposed	**(28)**	(5)
Net book value of assets written-off	**–**	(181)
Net gain/(loss) from disposal of assets	**(19)**	(185)

Note 6E. Licence fees and other charges

Licence fees finance sector entities	**296**	–
Superannuation trustee applications	**16**	14
Fees from foreign bank representative offices	**99**	106
Total licence fees and other charges	**411**	120

Note 6F. Insurance recoveries and other revenue

Insurance recoveries from liability insurer for costs associated with the HIH Royal Commission	**456**	3,248
Other revenue relating to recovery of prior year court costs and prior year compensation matters	**34**	10
Recovery from Reserve Bank of Australia for Scholarship	**25**	25
Income from sale of non-capitalised assets	**8**	–
Total insurance recoveries and other revenue	**523**	3,283

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

	2004 $'000	2003 $'000

Note 7. Operating expenses

Note 7A. Employee expenses

	2004 $'000	2003 $'000
Salaries and wages	**40,274**	34,152
Superannuation	**3,924**	3,139
Leave and other benefits	**2,050**	1,848
Separation and redundancy	**115**	83
Other employee expenses (see Note 1.2)	**187**	1,456
Total employee benefits expenses	**46,550**	40,678
Workers' compensation premiums and on-costs	**368**	273
Total employee expenses	**46,918**	40,951

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 18 per cent (2003: 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 22 per cent of salary (CSS), 14 per cent of salary (PSS) and 6 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 $1,046,506 (2002/03: $832,801) in relation to these schemes have been expensed in these financial statements. Employer Superannuation Productivity Benefit contributions totalled $212,944 (2002/03: $201,480).

Contributions on behalf of the balance of staff are made to various complying superannuation funds in accordance with the *Superannuation Guarantee (Administration) Act 1992.* Total contributions under these arrangements amount to $2,664,684 (2002/03: $2,306,508).

Note 7B. Supplier expenses

	2004 $'000	2003 $'000
Goods from related entities	–	–
Goods from external entities	**2,308**	1,854
Services from related entities[6]	**2,770**	1,874
Services from external entities	**11,753**	15,057
Operating lease rentals	**6,223**	5,210
Total supplier expenses	**23,054**	23,995

6 Includes expenses of $1,024 million (2002/03: $3.69 million) associated with HIH Royal Commission.

	2004 $'000	2003 $'000

Note 7C. Depreciation and amortisation

Depreciation of infrastructure, plant and equipment	**1,917**	1,642
Amortisation of intangibles	**2,039**	1,847
Total depreciation and amortisation	**3,956**	3,489

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

Computer hardware and office equipment	**957**	865
Leasehold improvements	**960**	777
Intangibles	**2,039**	1,847
Total depreciation and amortisation	**3,956**	3,489

Note 7D. Write-down of assets

Infrastructure, plant and equipment – revaluation decrement	**275**	–
Infrastructure, plant and equipment – write-off	**–**	4
Total write-down of assets	**275**	4

Note 7E. Value of assets disposed

Non-financial assets		
Cost of infrastructure, plant and equipment disposed (Note 6D)	**28**	185
Net book value of assets disposed	**28**	185

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

	2004 $'000	2003 $'000

Note 8. Financial assets

Note 8A. Cash

	2004 $'000	2003 $'000
Cash at bank and on hand	**18,632**	10,809
Deposits at call	**1**	6
Total cash	**18,633**	10,815

Note 8B. Receivables

	2004 $'000	2003 $'000
Special Appropriation	**1,813**	1,135
Less: Provision for doubtful debt related to outstanding levy debt	**(35)**	(12)
Annual appropriation 2001/02 re-issued	**–**	2,000
Net appropriations receivable	**1,778**	3,123
Goods and services (including rental recoveries and licence fees)	**667**	439
Less: Provision for doubtful debts	**(2)**	(2)
Net goods and services	**665**	437
Insurance recoveries	**–**	1,198
Accrued interest receivable	**77**	44
GST receivable	**559**	360
Total receivables (net)	**3,079**	5,162

All receivables are current assets

	2004 $'000	2003 $'000
Receivables (gross) are aged as follows:		
Not overdue	**2,861**	4,801
Overdue by:		
– Less than 30 days	**6**	337
– 30 to 60 days	**4**	2
– 60 to 90 days	**26**	9
– more than 90 days	**219**	27
	255	375
Total receivables (gross)	**3,116**	5,176
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	**(2)**	(5)
– more than 90 days	**(35)**	(7)
Total provision for doubtful debts	**(37)**	(14)
Total receivables (net)	**3,079**	5,162

	2004 $'000	2003 $'000

Note 9. Non-financial assets

Note 9A. Infrastructure, plant and equipment

	2004 $'000	2003 $'000
Computer hardware and office equipment		
– at cost	**–**	1,908
– accumulated depreciation	**–**	(354)
	–	1,554
– at 2001 valuation (deprival value)	**–**	2,286
– accumulated depreciation	**–**	(2,061)
	–	225
– at 2004 valuation (fair value)	**1,457**	–
Total computer hardware and office equipment	**1,457**	1,779
Leasehold improvements		
– at cost	**–**	2,373
– accumulated amortisation	**–**	(105)
	–	2,268
– at 2001 valuation (deprival value)	**–**	5,538
– accumulated amortisation	**–**	(4,043)
	–	1,495
– at 2004 valuation (fair value)	**2,616**	–
Total leasehold improvements	**2,616**	3,763
Total infrastructure, plant and equipment (non-current)	**4,073**	5,542

The revaluations performed in 2000/01 and 2003/04 were in accordance with the revaluation policy stated at Note 1.13 – *Property (infrastructure), plant and equipment* and were completed by an independent valuer, the Australian Valuation Office.

	2004 $'000	2003 $'000
Movement in asset revaluation reserve		
Decrement in computer hardware and office equipment	**(83)**	–
Decrement in leasehold improvements	**(22)**	–
Net movement	**(105)**	–

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

	2004 $'000	2003 $'000
Note 9. Non-financial assets (continued)		
Note 9B. Intangibles		
Computer software – internally developed – in use – at cost	**7,564**	7,269
Accumulated amortisation	**(3,602)**	(2,135)
	3,962	5,134
Computer software – purchased – at cost	**2,186**	1,717
Accumulated amortisation	**(974)**	(918)
	1,212	799
Computer software – purchased – deemed at cost (previously at valuation (1999))	**–**	588
Accumulated amortisation	**–**	(578)
	–	10
Computer software – internally developed – in progress – at cost	**200**	597
Computer software – purchased – in progress – at cost	**18**	–
	218	597
Total intangibles (non-current)	**5,392**	6,540

	$'000	$'000	$'000	$'000

Note 9C. 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	Leasehold improvements	Intangibles	Total
As at 1 July 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
Additions:				
by purchase	747	108	892	1,747
Net revaluation increment/decrement	(85)	(295)	–	(380)
Depreciation/amortisation expense	(956)	(960)	(2,040)	(3,956)
Disposals:				
Other disposals by sale and write-off (Net book value)	(28)	–	–	(28)
As at 30 June 2004				
Gross book value	**1,457**	**2,616**	**9,968**	**14,041**
Accumulated depreciation/amortisation	**–**	**–**	**(4,576)**	**(4,576)**
Net book value/fair value	**1,457**	**2,616**	**5,392**	**9,465**

As a result of the revaluation of infrastructure, plant and equipment to fair value at 30 June 2004, the accumulated depreciation/amortisation for these assets was reduced to nil, having been written back against the gross book value, to comply with AASB 1041.

Intangibles to the value of $2,065,000, having reached the end of their useful life and no longer in use, were retired at 30 June 2004, resulting in a reduction, by that amount, in both gross book value and accumulated amortisation.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 9. Non-financial assets (continued)

Note 9C. Analysis of infrastructure, plant and equipment and intangibles (continued)

Table B – Summary of balances of assets at valuation

	Computer hardware and office equipment $'000	Leasehold improvements $'000	Total $'000
As at 30 June 2004			
Gross value	1,457	2,616	4,073
Accumulated depreciation/amortisation	–	–	–
Fair value	1,457	2,616	4,073
As at 30 June 2003			
Gross value	2,286	5,538	7,824
Accumulated depreciation/amortisation	(2,061)	(4,043)	(6,104)
Net book value	225	1,495	1,720

Table C – Summary of balances of assets under construction

	Computer software intangibles
As at 30 June 2004	
Gross value	218
Accumulated depreciation/amortisation	–
Net book value	218
As at 30 June 2003	
Gross value	597
Accumulated depreciation/amortisation	–
Net book value	597

Note 9D. Other non-financial assets

	2004	2003
Pre-payments	581	294
Total other non-financial assets (current)	581	294

	2004 $'000	2003 $'000

Note 10. Payables

Note 10A. Supplier payables

	2004 $'000	2003 $'000
Trade creditors	**4,600**	2,962
Operating lease rentals	**–**	8
Total supplier payables	**4,600**	2,970

All supplier payables are current.

Note 10B. Other payables

	2004 $'000	2003 $'000
GST payable to the Australian Taxation Office	**65**	14
Total other payables	**65**	14

All other payables are current.

Note 10C. Revenue in advance

	2004 $'000	2003 $'000
Unearned annual appropriation revenue (see Note 6A)	**976**	2,000
Unearned fees and charges	**85**	–
Total revenue in advance	**1,061**	2,000

All revenue in advance is current.

Note 11. Provisions

Note 11A. Employee provisions

	2004 $'000	2003 $'000
Salaries and wages	**2,650**	3,181
Superannuation	**–**	–
Leave and other benefits	**10,321**	9,017
Separation and redundancy	**–**	–
Other	**101**	82
Aggregate employee benefit liability	**13,072**	12,280
Worker's compensation and on-cost	**–**	–
Aggregate employee benefit liability and related on-cost	**13,072**	12,280
Current	**7,023**	7,391
Non-current	**6,049**	4,889
	13,072	12,280

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 11. Provisions (continued)

Note 11B. Other provisions

	2004 $'000	2003 $'000
Surplus leased space	**170**	170
Make good premises at lease end	**634**	492
Lease incentives	**1,103**	1,336
Total other provisions	**1,907**	1,998
Current	**671**	468
Non-current	**1,236**	1,530
	1,907	1,998
Other provisions balance at 1 July	**1,998**	2,175
Increase/(decrease) in surplus leased space provision	**–**	(38)
Increase/(decrease) in make good provision	**142**	121
Increase/(decrease) in lease incentives provision	**(233)**	(260)
Other provisions balance at 30 June	**1,907**	1,998

APRA leases premises in Sydney, Melbourne, Canberra, Brisbane, Adelaide and Perth. There is a small area of surplus leased space in the Canberra office which has remained vacant for the whole of 2003/04, despite continued efforts to sub-let the area.

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

Lease incentives in the form of cash, rent-free periods and rental discounts were negotiated in the leases for the Sydney and Canberra premises and the provisions are being amortised over the term of the respective leases.

Note 12. Equity

	Contributed equity		Asset revaluation reserve		Accumulated results (see note)		Total equity	
	2004 $'000	2003 $'000	**2004 $'000**	2003 $'000	**2004 $'000**	2003 $'000	**2004 $'000**	2003 $'000
Opening balance as at 1 July	**5,255**	5,255	**487**	483	**3,349**	3,517	**9,091**	9,255
Net surplus/(deficit)	**–**	–	**–**	–	**2,067**	(168)	**2,067**	(168)
Net revaluation increment/ (decrement)	**–**	–	**(105)**	–	**–**	–	**(105)**	–
Adjustment	**–**	–	**–**	4	**–**	–	**–**	4
Closing balance as at 30 June	**5,255**	5,255	**382**	487	**5,416**	3,349	**11,053**	9,091

Note regarding accumulated results:
In 2001/02 an Annual Departmental Appropriation of $2.1 million was made to APRA to increase supervision of superannuation entities. A condition of the appropriation was that an equivalent amount was to be recovered from future supervisory levies and repaid to the Consolidated Revenue Fund (CRF). Under the FMOs, repayments of appropriations of this nature are an adjustment direct to equity and require the approval of the Minister for Finance. The process to return the $2.1 million has been set in train and, subject to the Minister's final approval, this amount is expected to be repaid from accumulated results to the CRF, in 2004/05. The effect of this would be to reduce accumulated results to $3.316 million as at 30 June 2004.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 13. Cash flow reconciliation

Note 13A: Reconciliation of operating surplus to net cash from operating activities:

	2004 $'000	2003 $'000
Operating surplus/(deficit) from ordinary activities	**2,067**	(168)
Non-cash items		
Depreciation and amortisation of infrastructure, plant and equipment	**1,917**	1,642
Amortisation of intangibles	**2,039**	1,847
Revaluation adjustment transferred to reserves	**(105)**	–
Infrastructure, plant and equipment revaluation decrement	**275**	–
Adjustment	**–**	4
Loss on disposal of infrastructure, plant and equipment	**19**	183
Changes in assets and liabilities		
(Increase)/decrease in receivables	**2,083**	(3,103)
(Increase)/decrease in other non-financial assets	**(287)**	36
Increase/(decrease) in revenue in advance	**(939)**	1,024
Increase/(decrease) in leases	**-**	–
Increase/(decrease) in employees liabilities	**792**	1,817
Increase/(decrease) in suppliers liabilities	**1,680**	54
Increase/(decrease) in other provisions and payables	**(91)**	(177)
Net cash from operating activities	**9,450**	3,159

Note 13B: Reconciliation of cash

	2004 $'000	2003 $'000
Cash balance comprises:		
Cash at bank and on hand	**18,632**	10,809
Deposits at call	**1**	6
Total cash	**18,633**	10,815
Balance of cash as at 30 June shown in the *Statement of cash flows*	**18,633**	10,815

Note 14. Contingent liabilities and assets

Note 14(a) Contingent liabilities

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

Note 14(b) Contingent assets

As stated in Note 14(a), the Authority is engaged in a number of legal cases at 30 June. The contingent asset represents an estimate of the legal costs arising from these actions likely to be recovered by APRA. The estimates have been provided by the legal practitioners representing the Authority or on judgments already entered.

Note 14(c) Unquantifiable contingencies

Of the legal matters unresolved at 30 June 2004, a number of the cases were at a stage where it was not possible to quantify the amounts of any eventual payments that may be required in relation to these claims.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

	2004 $	2003 $

Note 15. Remuneration of APRA Members

Following passage of the *Australian Prudential Regulation Authority Amendment Act 2003*, the previous APRA Board was replaced by a three-person Executive Group, whose full-time appointments took effect on 1 July 2003, although the third Member did not commence duties until 8 September 2003.

APRA Members are appointed by the Governor-General under Part 3 of the *Australian Prudential Regulation Authority Act 1998* and remuneration is set by the Remuneration Tribunal under the *Remuneration Tribunal Act 1973*. Total remuneration as determined by the Tribunal for 2003/04 was Chairman $490,000; Deputy Chairman $410,000; and Member $390,000. Any difference between the Tribunal determination and the remuneration reported below is due to changes in unused annual and long service leave entitlements accumulated in the year, plus any unused leave brought across from previous Commonwealth employers. With the exception of the full-time CEO, previous APRA Board Members were all part-time or ex-officio.

	2004 $	2003 $
Aggregate amount of superannuation payments in connection with the retirement of APRA Members (Board Members in 2002/03)	**114,944**	36,117
Other remuneration received or due and receivable by APRA Members (Board Members in 2002/03)	**1,339,142**	703,814
Total remuneration received or due and receivable by Members	**1,454,086**	739,931

The number of APRA Members (Board Members in 2002/03) included in these figures are shown below in the relevant remuneration bands:

			Number	Number
$nil	–	$10,000	**–**	3
$40,001	–	$50,000	**–**	3
$50,001	–	$60,000	**–**	1
$120,001	–	$130,000	**–**	1
$320,001	–	$330,000	**1**	–
$430,001	–	$440,000	**–**	1
$470,001	–	$480,000	**1**	–
$650,001	–	$660,000	**1**	–
Total number of APRA Members			**3**	9

Note16. Related party disclosures

APRA Executive Group (APRA Members)

The Members of the APRA Executive Group during the year were:

Dr John Laker (Chairman)
Mr Ross Jones (Deputy Chairman)
Mr Steve Somogyi (Member)

Transactions with APRA Member-related entities

There were no related entity transactions in 2003/04 in respect of APRA Members. In the prior year, however, there were transactions between APRA and the following entities related to previous Board Members: the Reserve Bank of Australia for banking services (2003 payments: $91,399; receipts $848,261); PricewaterhouseCoopers (2003: payments of $206,983 mainly for the provision of consulting services) and the Australian Securities and Investments Commission (2003: payments $36,934 related to staff secondment; receipts $11,636 for conduct of a joint seminar).

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

			2004 $	2003 $

Note 17. Remuneration of officers

	2004 $	2003 $
The aggregate amount of total remuneration of officers shown is:	**10,736,573**	9,333,742

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

			Number	**Number**
$110,001	–	$120,000	**1**	1
$120,001	–	$130,000	**2**	3
$130,001	–	$140,000	**3**	4
$140,001	–	$150,000	**8**	8
$150,001	–	$160,000	**5**	6
$160,001	–	$170,000	**4**	8
$170,001	–	$180,000	**7**	5
$180,001	–	$190,000	**5**	1
$190,001	–	$200,000	**4**	5
$200,001	–	$210,000	**6**	5
$210,001	–	$220,000	**4**	1
$220,001	–	$230,000	**4**	3
$230,001	–	$240,000	**1**	–
$250,001	–	$260,000	**1**	–
$280,001	–	$290,000	**–**	1
$300,001	–	$310,000	**1**	–
$320,001	–	$330,000	**–**	2
$330,001	–	$340,000	**1**	–
$350,001	–	$360,000	**1**	–
Total number of officers			**58**	53

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 2003/04, whose total remuneration exceeded $100,000 except the APRA Members (Chief Executive Officer in 2002/03). Details in relation to the APRA Members (and Chief Executive Officer in 2002/03), have been incorporated into Note 15 – *Remuneration of APRA Members*.

	2004 $	2003 $

Note 18. Remuneration of auditors

Remuneration to Auditor-General for auditing the financial statements for the reporting period.		
The fair value of services provided was:	**81,025**	73,514

The Auditor-General provided no other services during the reporting period.

Note 19. Average staffing levels

	Number	Number
The average number of employees for the Authority during the year was:	**496**	457

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 20. Financial instruments

Note 20A. 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	8A	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	8A	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 4.90 per cent (2002/03: 4.75 per cent). Interest is paid on maturity.
Appropriations receivable	8B	Appropriations receivable are recognised at nominal amounts due less any provision for bad and doubtful debts. Collectability of levies is reviewed at balance date. Provisions are made when collection of the levy debt is judged to be less rather than more likely.	Credit terms for receivables are net 30 days (2002/03: 30 days).
Receivables for goods and services	8B	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 (2002/03: 30 days).
Receivables for insurance recoveries and other revenue	8B	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 (2002/03: 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	10C	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.
Trade creditors	10A	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 20B. Interest rate risk

Financial instrument	Note	Floating interest rate		Fixed interest rate 1 year or less		Fixed interest rate 1 to 2 years		Fixed interest rate 2 to 5 years		Non-interest bearing		Total		Weighted average effective interest rate	
		2004 $'000	2003 $'000	**2004 $'000**	2003 $'000	**2004 $'000**	2003 $'000	**2004 $'000**	2003 $'000	**2004 $'000**	2003 $'000	**2004 $'000**	2003 $'000	**2004 %**	2003 %
Financial assets (recognised)															
Cash at bank and deposits at call	8A	**18,630**	10,812	**–**	–	**–**	–	**–**	–	**–**	–	**18,630**	10,812	**4.71**	4.40
Cash on hand	8A	**–**	–	**–**	–	**–**	–	**–**	–	**3**	3	**3**	3	**n/a**	n/a
Commonwealth and State Government securities	8A	**–**	–	**–**	–	**–**	–	**–**	–	**–**	–	**–**	–	**–**	–
Appropriations receivables	8B	**–**	–	**–**	–	**–**	–	**–**	–	**1,778**	3,123	**1,778**	3,123	**n/a**	n/a
Goods and services receivable	8B	**–**	–	**–**	–	**–**	–	**–**	–	**665**	437	**665**	437	**n/a**	n/a
Accrued interest	8B	**–**	–	**–**	–	**–**	–	**–**	–	**77**	44	**77**	44	**n/a**	n/a
Other receivables	8B	**–**	–	**–**	–	**–**	–	**–**	–	**559**	1,558	**559**	1,558	**n/a**	n/a
Total financial assets (recognised)		**18,630**	10,812	**–**	–	**–**	–	**–**	–	**3,082**	5,165	**21,712**	15,977		
Total assets												**31,758**	28,353		
Financial liabilities (recognised)															
Revenue in advance	10C	**–**	–	**–**	–	**–**	–	**–**	–	**1,061**	2,000	**1,061**	2,000	**n/a**	n/a
Trade creditors	10A, B	**–**	–	**–**	–	**–**	–	**–**	–	**4,665**	2,984	**4,665**	2,984	**n/a**	n/a
Total financial liabilities (recognised)		**–**	–	**–**	–	**–**	–	**–**	–	**5,726**	4,984	**5,726**	4,984		
Total liabilities												**20,705**	19,262		

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 20. Financial instruments (continued)

Note 20C. Net fair values of financial assets and liabilities

	Note	2004 $'000 Total carrying amount	2004 $'000 Aggregate net fair value	2003 $'000 Total carrying amount	2003 $'000 Aggregate net fair value
Financial assets					
Cash at bank	8A	**18,630**	**18,630**	10,812	10,812
Cash on hand	8A	**3**	**3**	3	3
Receivables – appropriations	8B	**1,778**	**1,778**	3,123	3,123
Receivables – goods and services	8B	**665**	**665**	437	437
Receivables – accrued interest	8B	**77**	**77**	44	44
Receivables – other	8B	**559**	**559**	1,558	1,558
Total financial assets		**21,712**	**21,712**	15,977	15,977
Financial liabilities (recognised)					
Trade creditors and other payables	10A,B	**4,665**	**4,665**	2,984	2,984
Revenue in advance	10C	**1,061**	**1,061**	2,000	2,000
Total financial liabilities (recognised)		**5,726**	**5,726**	4,984	4,984

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 trade creditors and other payables and revenue in advance are approximated by their carrying amounts.

Note 20D. 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*.

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

	2004 $'000	2003 $'000

Note 21. Administered items

Note 21A – Revenues administered on behalf of Government for the year ended 30 June 2004

	2004 $'000	2003 $'000
Revenues		
Taxation		
Financial institutions supervisory levies		
current year levies and penalties (see Table 1)[7]	**86,868**	74,733
current year levies recognised in previous period	**(28,192)**	(23,481)
	58,676	51,252
future year levies recognised in current period (see Table 2)[8]	**–**	28,192
Financial Assistance Levy and penalties	**7,616**	–
Total taxation	**66,292**	79,444
Non-Taxation		
Enforceable Undertaking (superannuation entity)[9]	**1,000**	–
Total revenues administered on behalf of Government	**67,292**	79,444

Table 1: Financial institutions supervisory levies revenue by levy type – current year levies and penalties[10]

	2004 $'000	2003 $'000
Levy:		
Superannuation funds	**36,053**	30,512
Authorised deposit-taking institutions	**27,602**	23,753
Life insurers and friendly societies	**9,990**	9,044
General insurers	**13,016**	11,260
Retirement savings account providers	**114**	74
Total levies	**86,775**	74,643
Late payment penalties:		
Superannuation funds	**87**	66
Total late payment penalties	**87**	66
Late lodgement penalties:		
Superannuation funds	**6**	24
Total late lodgement penalties	**6**	24
Total current year levies and penalties	**86,868**	74,733

7 Current year levies and penalties include amounts for past years' levies and penalties invoiced in the current year. In addition, the total amount shown for 2002/03 includes an opening adjustment of $900,000 relating to 2001/02 levies that were not reported in 2001/02.

8 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. No amounts were received in 2003/04, as the 2004/05 levies were not determined until late in June 2004.

9 Payment by a trustee in settlement of any potential civil penalty actions against the trustee or its directors.

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

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 21: Administered items (continued)

	2004 $'000	2003 $'000
Table 2: Financial institutions supervisory levies revenue by levy type – future year levies recognised in current period		
Levy:		
Superannuation funds	**–**	–
Authorised deposit-taking institutions	**–**	16,765
Life insurers and friendly societies	**–**	3,241
General insurers	**–**	8,186
Retirement savings account providers	**–**	–
Total future year levies recognised in current period	**–**	28,192
Table 3: Financial Assistance Levy and penalties		
Levy No. 2001/02:1 (Superannuation)		
Levy	**7,596**	–
Penalties	**20**	–
Total Financial Assistance Levy and penalties	**7,616**	–

	2004 $'000	2003 $'000

Note 21B. Expenses administered on behalf of Government for the year ended 30 June 2004

	2004 $'000	2003 $'000
Expenses:		
Net write-down of assets		
Financial institutions supervisory levies		
Levies and late payment penalties waived (see Table 1)[11]	**(767)**	(257)
Levies and late payment penalties written-off (see Table 2)	**(13)**	(122)
	(780)	(379)
Financial Assistance Levy		
Levies and late payment penalties written-off (see Table 3)	**(6)**	–
Total expenses administered on behalf of the Government	**(786)**	(379)

Table 1: Financial institutions supervisory levies – levies and late payment penalties waived by levy type

	2004 $'000	2003 $'000
Superannuation funds	**(436)**	(255)
Life insurers	**(331)**	(2)
Total levies and late payment penalties waived	**(767)**	(257)

Table 2: Financial institutions supervisory levies – levies and late payment penalties written-off by levy type

	2004 $'000	2003 $'000
Superannuation funds	**(13)**	(61)
Life insurers and friendly societies	**–**	(61)
Total levies written-off	**(13)**	(122)

Table 3: Financial Assistance Levy – levies and late payment penalties written-off

	2004 $'000	2003 $'000
Financial Assistance Levy No. 2001/02: 1 (Superannuation)	**(6)**	–
Total financial assistance levies written–off	**(6)**	–

11 The number of levies and late payment penalties waived in 2004 was 127 (2003: 139). These waivers were made under section 12 of the *Financial Institutions Supervisory Levies Collection Act 1998*. The total amount of these waivers was $766,844 (2003: $257,460).

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 21. Administered items (continued)

Note 21C – Assets administered on behalf of Government as at 30 June 2004

	2004 $'000	2003 $'000
Financial assets		
Cash		
Cash at bank [12]	**–**	1,930
Receivables		
Financial institutions supervisory levies		
Superannuation levies	**125**	221
Less: Provision for doubtful debts	**(35)**	(12)
Net financial institutions supervisory levies receivable	**90**	209
Financial Assistance Levy receivable	**14**	–
Total receivables	**104**	209
Accrued revenue		
Financial institutions supervisory levies		
Superannuation levies	**–**	20
Total accrued revenues	**–**	20
Total financial assets	**104**	2,159
Total assets administered on behalf of Government	**104**	2,159
Receivables which are overdue are aged as follows:		
Not overdue	**8**	167
Overdue by:		
– Less than 30 days	**6**	18
– 30 to 60 days	**4**	2
– 60 to 90 days	**24**	34
– more than 90 days	**97**	–
Total levies receivable	**139**	221
The provision for doubtful debts is aged as follows:		
Not overdue	**–**	–
Overdue by:		
– Less than 30 days	**–**	–
– 30 to 60 days	**–**	–
– 60 to 90 days	**(2)**	(1)
– more than 90 days	**(33)**	(11)
Total provision for doubtful debts	**(35)**	(12)
Total receivables (net)	**104**	209

12 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.

	2004 $'000	2003 $'000

Note 21D – Administered reconciliation table

Opening administered assets less administered liabilities at 1 July	**2,159**	815
Plus administered revenues	**66,292**	79,444
Adjustment to prior year revenue	**–**	(900)
Plus penalty collected	**1,000**	–
Less administered expenses	**(786)**	(379)
Plus transfers from Official Public Account for refunds	**825**	231
Less transfers to Official Public Account	**(69,386)**	(77,052)
Closing administered assets less administered liabilities	**104**	2,159

There were no administered commitments or contingencies for 2003/04 (2002/03: Nil).

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 21. Administered items (continued)

Note 21E – 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		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	21C	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*. Administered revenue arising from levies on superannuation entities (including the Financial Assistance Levy) is recognised upon issue of invoice while administered revenue in respect of levies on all other entities is recognised on the date it becomes due and payable to APRA or on the date the payment is received, whichever occurs first. Levies are recognised at the nominal amounts due less any provision for bad or doubtful debts. The collectability of debts is reviewed at balance date. Provisions are made when collection of the debt is judged to be less, rather than more, likely.
Accrued revenues	21C	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	2004 $'000	2003 $'000	2004 $'000	2003 $'000

Note 21F– Administered financial instruments (continued)

(b) Interest rate risk

Financial instrument		Non–interest bearing		Total	
Financial assets (recognised)					
Cash	21C	–	1,930	–	1,930
Receivables	21C	**104**	209	**104**	209
Accrued revenue	21C	–	20	–	20
Total financial assets (recognised)		**104**	2,159	**104**	2,159
Total assets		**104**	2,159	**104**	2,159

(c) Net fair values of financial assets

		Total carrying amount		Aggregate net fair value	
Financial assets					
Cash	21C	–	1,930	–	1,930
Receivables	21C	**104**	209	**104**	209
Accrued revenue	21C	–	20	–	20
Total financial assets		**104**	2,159	**104**	2,159

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 21C.

The Commonwealth's highest credit risk exposure is levies of $124,324 (2003: $221,213) receivable at 30 June 2004 from superannuation funds regulated by APRA. The asset has been recognised in Note 21C, net of a provision for doubtful debts.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 22. Appropriations

The table in Note 22A and Table 1 in Note 22B 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 22B relates to a Special Appropriation, which is administered on behalf of the Government.

Note 22A. Acquittal of Authority to draw cash from the Consolidated Revenue Fund (Appropriation) Acts 1 and 3

Particulars	Departmental outputs		Total	
	2004 $'000	2003 $'000	**2004 $'000**	2003 $'000
Appropriation Act No.3 (2001/02)				
Purpose: funding in respect of HIH Royal Commission				
Balance carried forward from previous year	**2,000**	–	**2,000**	–
Re-issue of appropriation from previous year	**–**	2,500	**–**	2,500
Appropriation for reporting year	**–**	–	**–**	–
Available for payment from CRF	**2,000**	2,500	**2,000**	2,500
Payments made out of CRF	**(2,000)**	(500)	**(2,000)**	(500)
Balance carried forward to next year	**–**	2,000	**–**	2,000
Represented by:				
Appropriations receivable	**–**	2,000	**–**	2,000

Note 22B. Acquittal of Authority to draw cash from the Consolidated Revenue Fund – Special Appropriations (limited amount)

Table 1: Special Appropriation (limited amount)

Particulars	Departmental outputs		Total	
	2004 $'000	2003 $'000	**2004 $'000**	2003 $'000
***Australian Prudential Regulation Authority Act 1998* – section 50**				
Purpose: funding of APRA				
Balance carried forward from previous year	**1,126**	815	**1,126**	815
Prior year balance adjustment	**(3)**	–	**(3)**	–
Appropriation for reporting year	**69,285**	59,686	**69,285**	59,686
Available for payment from CRF	**70,408**	60,501	**70,408**	60,501
Payments made out of CRF	**(68,630)**	(59,375)	**(68,630)**	(59,375)
Balance carried forward to next year	**1,778**	1,126	**1,778**	1,126
Represented by:				
Appropriations receivable	**1,778**	1,126	**1,778**	1,126

Particulars	2004 $'000 Administered	2003 $'000	2004 $'000 Total	2003 $'000
Table 2: Special Appropriation (unlimited amount)				
***Financial Management and Accountability Act 1997* section 28**				
Purpose: to refund overpayments of levies by financial institutions				
Budget estimate	**–**	–	**–**	–
Payments made out of CRF	**(825)**	(232)	**(825)**	(232)

Note 23. Assets held in trust

Services for other Governments and Non-agency Bodies Account

This account existed under the predecessor agency the Insurance and Superannuation Commission. Upon transformation of that agency to APRA on 1 July 1998, there was a nil balance in that account and no transactions have occurred since that time. Balance at 30 June 2004 is nil.

Note 24. 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. There were no transactions to this account in 2003/04 (2002/03: $nil).

Note 25. Reporting of outcomes

Note 25A – Outcomes of the Authority

APRA is structured to meet the following outcome:

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

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

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 25. Reporting of outcomes (continued)

Note 25B – Net cost of outcome delivery

	2004 $'000	2003 $'000
		Outcome 1
Administered expenses	**786**	379
Departmental (Authority) expenses	**74,231**	68,624
Total expenses	**75,017**	69,003
Costs recovered from provision of goods and services to the non-government sector		
Administered	**–**	–
Departmental (Authority)	**2,206**	1,287
Total costs recovered	**2,206**	1,287
Other external revenues		
Administered		
Financial institutions supervisory levies	**58,676**	79,433
Financial Assistance Levy	**7,616**	–
Enforcement penalty	**1,000**	–
Total Administered	**67,292**	79,433
Departmental (Authority)		
Sale of goods and services – to related entities	**1,520**	1,619
Interest	**1,731**	1,114
Revenue from sale of assets	**9**	1
Insurance recoveries and other revenue	**523**	3,283
Total departmental (Authority)	**3,783**	6,017
Total other external revenues	**71,075**	85,450
Total revenues	**73,281**	86,737
Net cost/(contribution) of outcome	**1,736**	(17,734)

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

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

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

	Output 1.1.1 policy development 2004 $'000	Output 1.1.1 policy development 2003 $'000	Output 1.1.2 surveillance program 2004 $'000	Output 1.1.2 surveillance program 2003 $'000	Output 1.1.3 prudential advice 2004 $'000	Output 1.1.3 prudential advice 2003 $'000	Total 2004 $'000	Total 2003 $'000
Authority operating expenses								
Employees	**4,458**	6,141	**38,577**	29,654	**3,883**	5,156	**46,918**	40,951
Suppliers – normal operations	**2,192**	3,683	**18,955**	13,947	**1,907**	2,675	**23,054**	20,305
Suppliers – HIH Royal Commission expenses[13]	**–**	–	**–**	–	**–**	3,690	**–**	3,690
Depreciation and amortisation	**376**	392	**3,252**	2,813	**328**	284	**3,956**	3,489
Write-off of assets and value of assets sold	**29**	28	**249**	137	**25**	24	**303**	189
Total Authority operating expenses	**7,055**	10,244	**61,033**	46,551	**6,143**	11,829	**74,231**	68,624
Funded by:								
Revenues from Government	**6,680**	6,595	**57,809**	46,186	**5,820**	8,371	**70,309**	61,152
Sale of goods and services	**223**	175	**1,928**	1,224	**194**	303	**2,345**	1,702
Rent recoveries	**92**	111	**798**	779	**80**	194	**970**	1,084
Interest	**165**	120	**1,423**	842	**143**	152	**1,731**	1,114
Proceeds from disposal of assets	**1**	–	**7**	1	**1**	–	**9**	1
Licence fees and other charges	**39**	12	**338**	86	**34**	22	**411**	120
Insurance recoveries and other revenue	**–**	–	**–**	–	**523**	3,283	**523**	3,283
Total Authority revenues	**7,200**	7,013	**62,303**	49,118	**6,795**	12,325	**76,298**	68,456

13 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 $1,024,000 (2003: $780,000) are instead reported as part of Employees expenses under Output 1.1.3.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2004

Note 25. Reporting of outcomes (continued)

Note 25D – Administered revenues and expenses by outcome

	2004 $'000	2003 $'000
		Outcome 1
Operating revenues		
Financial institution supervisory levies	**58,676**	78,532
Financial Assistance Levy	**7,616**	–
Enforceable undertaking	**1,000**	–
Total operating revenues	**67,292**	78,532
Operating expenses		
Levies waived	**767**	257
Levies written-off	**13**	122
Financial Assistance Levy written-off	**6**	–
Total operating expenses	**786**	379

The Authority's outcome is described at Note 25A.

Australian National
Audit Office

INDEPENDENT AUDIT REPORT

To the Minister for Revenue and Assistant Treasurer

Scope

The financial statements comprise:
- Statement by 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

  of the Australian Prudential Regulation Authority for the year ended 30 June 2004.

The Members are responsible for the preparation and true and fair presentation of the financial statements in accordance with the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial statements.

Audit approach

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

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

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

The audit opinion is formed on the basis of these procedures, which included:
- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial statements; and
- assessing the appropriateness of the accounting policies and disclosures used, and the reasonableness of significant accounting estimates made, by the Members.

Independence

In conducting the audit, I have followed the independence requirements of the Australian National Audit Office, which incorporate Australian professional ethical pronouncements.

Audit opinion

In my opinion, the financial statements:

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

(ii) give a true and fair view, of the matters required by 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 2004, and of its performance and cash flows for the year then ended.

Australian National Audit Office

P Hinchey
Senior Director
Delegate of the Auditor-General

Sydney, 24 August 2004

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

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STATUTORY REPORT

Statutory reporting requirements index

APRA has reported in accordance with the following Commonwealth legislation:

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

Australian Prudential Regulation Authority Act 1998 (APRA Act)

Report under section 59

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

- the activities of ADI statutory managers within the meaning of the *Banking Act 1959* and persons conducting investigations under Division 2 of Part II and section 61 of that Act; and
- the exercise during the year of APRA's powers under Part 15 of the *Retirement Savings Accounts Act 1997* 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 2003/2004. 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:

Commonwealth Authorities and Companies Act 1997 (CAC Act)

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 accepted the ANAO's recommendations and has been implementing them over the course of the year.

In addition, see page 58 of the *Financial statements* in this Report.

Executive Group attendance

See page 54 of the *Corporate governance* section of this Report.

Executive Group qualifications

See pages 56 – 57 of the *Corporate governance* section of this Report.

Statement by Members

See page 58 of the *Financial statements* in this Report.

Exemption number	Date	Provision of SIS regulations exempted
130	22/12/03	Sub-regulations 6.18(1) and 6.19(10)
131	12/08/03	Section 93(3)
132	3/12/03	Section 93(4)
133	7/01/04	Regulation 9.29
134	4/05/04	Sub-regulation 6.17(2)
135	20/04/04	Sub-regulations 6.18(1) and 6.19(1)
136	12/05/04	Regulation 9.29
137	15/06/04	Regulations 9.29 and 9.30
139	25/06/04	Regulations 9.29 and 9.30
140	25/06/04	Regulations 9.29 and 9.30
141	30/06/04	Regulation 6.29

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 and tribunal 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 58 of the *Financial statements* in this Report.

Indemnities and insurance premiums

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

APRA Members and officers are covered by the professional indemnity insurance cover of the Commonwealth-managed insurance fund, Comcover. The generic terms and conditions of the insurance cover provided by Comcover to Commonwealth agencies are available on the Comcover 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 126 – 127 of this Report.

Parliamentary committees

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

During 2003/04, APRA Members and officers made themselves available for public hearings before the following Committees:

- the Senate Economics Legislation Committee (sitting as Senate Estimates);
- the Senate Select Committee on Superannuation: Reference on Portability of Superannuation;
- the Senate Economics Legislation Committee: Reference on the *Superannuation Safety Amendment Bill 2003*;
- the Joint Committee of Public Accounts and Audit: Reference on the Review of Auditor-General's Report into the Review of APRA's Prudential Supervision of Superannuation Entities; and
- the Senate Economics Legislation Committee: Reference on the *Treasury Legislation Amendment (Professional Standards) Bill 2003.*

In addition, APRA Members and officers appeared before the House of Representatives Standing Committee on Economics, Finance and Public Administration, which was reviewing APRA's handling of its regulatory and supervisory responsibilities. Ahead of this appearance, an informal briefing was held between members of this Committee and APRA Members.

Privacy Commission

There were no investigations by the Privacy Commissioner under section 36 of the *Privacy Act 1988* during 2003/04. 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
Legal Services
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Phone: 02 9210 3000
Fax: 02 9210 3424

Responsible ministers

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

During the reporting period he was assisted in this by Senator the Hon Helen Coonan, Minister for Revenue and Assistant Treasurer and, from 18 July 2004, the Hon Mal Brough MP, 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 55 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 2004

Level	Female	Male	ATSI	NESB1	NESB2	PWD
Level 1	54	12	0	13	1	1
Level 2	70	45	0	26	1	2
Level 3	69	92	0	39	4	1
Level 4	34	76	0	22	2	1
Senior	9	57	1	10	1	1
Executive	0	6	0	2	0	0
Total	**236**	**288**	**1**	**112**	**9**	**6**

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;
- the 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 and it is examining alternative models to optimise diversity throughout 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 2003/04, APRA received nine applications under the FOI Act and no applications for internal review.

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

Granted in full	1
Granted in part	0
Access refused	2
Withdrawn	2
Transferred to another agency	1
On hand at 30 June 2004	3
Total	**9**

While charges collected were $280.00, the estimated cost of handling FOI requests in 2003/04 was $2,500.

In May 2004, a number of Commonwealth agencies, including APRA, were selected to be the subject of an investigation by the Commonwealth Ombudsman on the quality of agency processes for dealing with FOI requests. APRA has cooperated with the investigation by answering a questionnaire and providing a number of files to the Ombudsman. The investigation is still current.

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

Access to documents

APRA is increasingly using the internet to make its publications available to the public 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 at *www.apra.gov.au*
  - lists of regulated entities and industry bodies;
  - prudential standards and rules made under the *Banking Act 1959*, the *Insurance Act 1973* and the *Life Insurance Act 1995*, 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 by APRA members and officers;
- *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 regulated entities and industry bodies prior to formulating or amending prudential policies or finalising prudential standards.

Executive and consultative committees from 1 July 2003 to 30 June 2004

Management Group

This Group comprised the APRA Members and the Executive General Managers and was responsible for high-level information sharing and decisions on more routine supervisory and organisational matters.

Leadership Team

The Leadership Team met in March 2004 to consider APRA's future direction, and will meet on a regular basis to develop APRA's business plan and to monitor performance against it.

Industry groups

There are four groups which cover the following sectors:

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

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

Cross-Divisional Licensing Committee

The Committee seeks to ensure consistency in licensing practice and application across all APRA-regulated industries. It provides APRA-wide guidance on issues which need to be considered in licensing submissions and, after consideration of an application, recommends to the relevant Executive General Manager the action that 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.

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, Safety and Well-being 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 Statistics staff on APRA's preferences for new prudential policy formation. It reviews the policy agenda and provides input to the division's reports to senior management.

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.

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 2002/2003*, the Department of Industry Science and Resources showed that overall energy consumption per person in APRA offices was 8,701 MJ, a reduction over the previous year and well below the target of 10,000 MJ/person.

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

Commonwealth Fraud Control Guidelines

Fraud control

The Chairman of APRA certifies that he is satisfied that:

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

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

Responsibilities imposed by the OHS Act were identified and allocated to individual staff members. This 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.

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

Arrangements are in place for consultation on all OHS issues, including 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, nine 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	3
Home to work/work to home	2
Other	4
Total	**9**

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; recruitment selection, administration and outplacement and counselling; and professional services.

The total number of consultants engaged was 132 and the total amount paid was $5.5 million.

Performance pay

APRA has a performance bonus system, designed in consultation with staff and management and covering all employees. For 2003/04, the aggregate bonus pool was just over $2.1 million. Bonuses were paid early in July 2004.

Staff by location and full-time/part-time as at 30 June 2004

Location	Full-time	Part-time	Total
Adelaide	5	0	5
Brisbane	19	3	22
Canberra	24	25	49
Melbourne	57	5	62
Perth	8	0	8
Sydney	362	16	378
Total	**475**	**49**	**524**

Staff by division and full-time/part-time as at 30 June 2004

Division	Full-time	Part-time	Total
Corporate	119	27	146
Diversified Institutions Division	88	4	92
Policy, Research and Consulting	99	5	104
Specialised Institutions Division	169	13	182
Total	**475**	**49**	**524**

ORGANISATIONAL CHART

Executive Group

John Laker (Chairman)
Ross Jones (Deputy Chairman)
Steve Somogyi (Member)

Executive General Manager
Diversified Institutions Division
Wayne Byres

- General Manager
  Branch 1
  Senthamangalam Venkatramani
- General Manager
  Branch 2
  David Lewis
- General Manager
  Branch 3
  Mark Baxter
- General Manager
  Branch 4
  Keith Chapman

Executive General Manager
Specialised Institutions Division
Brandon Khoo

- General Manager
  Central Region
  TBA
- General Manager
  Northern Region
  Puay Sim
- General Manager
  South West Region
  Stephen Glenfield
- General Manager
  Superannuation Licensing
  Tony Randle

As at end September 2004

Risk Management and Audit Committee

Secretary
Thea Rosenbaum

Executive General Manager
Supervisory Support Division
Tom Karp

- General Manager
  Industry Technical Services
  Helen Martin
- General Manager
  Actuarial Services
  David Rush
- General Manager
  Specialist Risk Services
  Graham Johnson
- General Counsel
  Legal Services
  Chris Fogarty
- General Manager
  Enforcement
  Darryl Roberts

Executive General Manager
Policy Research and Statistics
Charles Littrell

- General Manager
  Policy and Development
  Greg Brunner
- General Manager
  Quantitative Analysis
  TBA
- Program Director
  Basel II
  Bernie Egan

Chief Financial Officer
Jim Flaye

General Manager
Human Resources
Peter Vodicka

Chief Information Officer
Colin Cayless

General Manager
Risk Assessment and
Internal Audit
Jon Tyers

General Manager
Quality Assurance
and Consistency
John Doble

Head of Public Affairs
Susan Morey

Info Line: 1300 131 060

Website: www.apra.gov.au

Email: APRAinfo@apra.gov.au

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400 George Street (Level 26)
Sydney NSW 2000

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Sydney NSW 2001

Telephone: 02 9210 3000
Facsimile: 02 9210 3411

OTHER OFFICES

Australian Capital Territory

243-251 Northbourne Avenue
(Level 2)
Lyneham ACT 2602

GPO Box 9836
Canberra ACT 2601

Telephone: 1300 131 060
Facsimile: 02 6213 5307

Queensland

300 Queen Street (Level 23)
Brisbane QLD 4000

GPO Box 9836
Brisbane QLD 4001

Telephone: 07 3001 8500
Facsimile: 07 3001 8501

South Australia

Allianz Centre (Level 5)
100 Pirie Street
Adelaide SA 5000

GPO Box 9836
Adelaide SA 5001

Telephone: 08 8235 3200
Facsimile: 08 8232 5180

Victoria

Casselden Place (Level 21)
2 Lonsdale Street
Melbourne VIC 3000

GPO Box 9836
Melbourne VIC 3001

Telephone: 03 9246 7500
Facsimile: 03 9663 5085

Western Australia

QV.1 Building (Level 9)
250 St Georges Terrace
Perth WA 6000

GPO Box 9836
Perth WA 6001

Telephone: 08 9481 8266
Facsimile: 08 9481 8142

APRA