APRA Annual Report 2007

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

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

APRA currently supervises institutions holding approximately $3 trillion in assets for 21 million Australian depositors, policyholders and superannuation fund members.

ISSN 1442-7885 (Print)
ISSN 1834-0660 (Online)

This Report is available online at: http://www.apra.gov.au/AboutAPRA/Annual-Report-2007.cfm

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

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

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

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

Integrity

Collaboration

Professionalism

Foresight

Accountability

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

Contents

1 From the Chairman

The Australian financial system in 2006/07 continued to reap the dividends of Australia's long run of economic success. However, some of the shine from this positive picture has been lost in the volatility that has affected financial markets, globally and in Australia, since year end.

All industries supervised by APRA performed well over the year in a very competitive environment. Deposit-taking institutions enjoyed further brisk growth in activity that generated good profitability; capital levels and asset quality overall remained sound, although pockets of weakness in mortgage lending have emerged. Insurance companies maintained a strong underwriting performance and capital position. The superannuation industry, now well settled into the new supervisory regime, garnered substantial inflows from the Government's 'Better Super' reforms and, together with the life insurance industry, recorded another year of high growth and favourable investment returns.

Throughout 2006/07, dealing with the implications of sustained good economic times captured much of APRA's attention. These are the times in which APRA must keep its day-to-day supervision squarely focussed on its preferred role – prevention rather than cure – and continually test that Australia's supervisory framework is capable of underpinning the safety of the financial system in less favourable times. These were APRA's main priorities in another busy year. With major reform initiatives completed a year earlier, however, APRA's agenda for strengthening the supervisory framework was lighter.

Recent market turbulence, triggered by the sharp deterioration in the US sub-prime mortgage market, has put an end to any complacent view that markets will not ultimately penalise participants that have underpriced risk in good economic times, or whose own risk profile is opaque. Markets are now playing out themes that have been emphasised by prudential regulators and central banks for some time – the importance of identifying risk, ensuring it is priced appropriately, managing risk carefully and holding adequate capital against unexpected losses. In this context, price transparency is also critical.

The Australian financial system has only very limited direct exposures to the US sub-prime mortgage market but it is not immune to recent increases in wholesale funding costs nor to the market's heightened caution about certain types of credit products and business models. That said, the fundamental strength of the financial system and Australia's robust supervisory framework leave financial institutions well positioned to weather the turbulence. Moreover, the strong momentum of the global and Australian economies looks set to continue, which augurs well for the range of financial activities in which supervised institutions participate.

APRA's mandate

During 2006/07, APRA's mandate as Australia's integrated prudential regulator was reconfirmed in the Government's *Statement of Expectations* of APRA. This was part of a reform to the governance arrangements for statutory authorities, endorsed as well by the Government's Taskforce on Reducing Regulatory Burdens on Business (the 'Regulation Taskforce'). The *Statement of Expectations* and APRA's *Statement of Intent* in response are reproduced in this Report.

In the *Statement of Expectations*, the Government acknowledged that it was very pleased with the overall performance of APRA and that it recognised and will continue to respect the operational independence of APRA. These acknowledgments were welcome.

Importantly, the Government has confirmed that prudential regulation should not pursue a 'zero failure' objective. Rather, the objective is to maintain a low incidence of failure of supervised institutions while not impeding continued improvements in efficiency or hindering competition. APRA fully supports this objective. From its establishment, APRA has accepted that it cannot eliminate the risk of failure and that any attempt to do so would impose unnecessary burden on financial institutions and harden the arteries of the Australian financial system.

The *Statement of Expectations* provides helpful signposts for APRA's future direction but does not call for any fundamental change of course. APRA's response focusses on further improvements to the efficiency and effectiveness of its supervisory activities, and on enhancing transparency and accountability.

On the latter, APRA will be releasing a Service Charter that sets out the key rights and responsibilities of APRA, its supervised institutions and members of the community who have dealings with APRA. It will also be developing a broader suite of performance indicators beyond the safety measures it has been publishing in recent years. A word of caution is appropriate here. Meaningful analysis of the contribution of prudential regulation is a challenging task for APRA, and its overseas counterparts as well. The 'costs' can easily be overstated, particularly if they cannot be readily disentangled from the day-to-day costs of conducting business well; 'benefits' can also be hard to discern if public confidence in the financial system is also supported by a range of positive macroeconomic and other factors. The real test of the contribution of prudential regulation comes during periods of financial stress, where a robust supervisory framework would be more likely to contain the damage. However, this potential contribution does not lend itself to simple quantitative indicators.

On this score, APRA welcomes the findings from the benchmarking of Australia's regulatory arrangements conducted by the International Monetary Fund under a global review program. These arrangements were judged to have a generally high level of compliance with international standards and, in a number of areas, Australia is at the forefront of best practice. The review concluded that the Australian financial system is mature and strong, and financial supervision is sound.

APRA's supervisory approach

APRA's efficiency and effectiveness depend crucially on the supervisory framework – the 'rules of the game', so to speak – and how APRA applies these rules in its normal supervisory activities.

In its *Statement of Intent*, APRA re-affirmed its commitment to moving to a more flexible, principles-based approach in its development of the supervisory framework. A principles-based approach recognises the complexity and diversity that exists among financial institutions and seeks to avoid a one-size–fits-all solution. APRA took further steps in this direction in 2006/07.

The period of intense reform activity in previous years, in which the new licensing regime for superannuation and second-round reforms in general insurance were prominent, had brought APRA much closer to its goal of upgrading Australia's supervisory framework. In 2006/07, APRA's main priorities were the implementation of the new global capital adequacy regime for deposit-taking institutions (the Basel II Framework), the harmonisation of prudential standards in life insurance and further development of the supervisory framework for general insurance conglomerates. APRA also worked closely with the Government to implement the 'streamlining regulation' recommendations of the Regulation Taskforce, which are aimed at improving the flexibility and consistency of the supervisory framework and reducing compliance burdens.

A number of APRA's reform measures, particularly some of those dealing with capital adequacy, are highly technical in nature and do not suit a principles-based approach. However, in other areas – such as outsourcing and market risk – APRA was able to recast previously detailed prescriptive requirements into the form of non-binding prudential practice guides to assist institutions to reconcile their specific business objectives and models with APRA's principles for prudent risk management. APRA has also foreshadowed a less intrusive approach in areas such as securitisation and the appointment of auditors and actuaries, where the need for prior approvals by APRA can subtract from the responsibility of the institutions themselves. When these latter changes are complete, APRA will no longer be involved in the prior vetting of any senior appointments to a supervised institution, from board director down.

In its normal supervision, APRA pursues a risk-based approach that targets its attention and supervisory resources on those institutions facing greater risk. Timely and proportionate intervention is essential to APRA's effectiveness. APRA aims to bring any substantial concerns to the attention of boards and senior management early and enlist them in corrective action, well before a heavier hand becomes necessary. APRA's relationships with boards, which APRA's Executive Group has been keen to promote, are proving time and again a very constructive way of bringing supervisory issues and commercial realities face-to-face.

APRA's risk-based approach is underpinned by a rigorous and sophisticated system for assessing emerging risks in a supervised institution and for determining the supervisory response. The signals from this risk-rating system are critical and receive careful scrutiny within APRA. A dull warning signal when an institution is coming under financial stress would discourage a prompt and appropriate APRA response; on the other hand, a strong warning signal when an institution is not in financial difficulty may encourage an over-zealous and unnecessary response. A prudential watchdog must bark, but not constantly at shadows! The review conducted by the International Monetary Fund, mentioned above, found that APRA's risk-rating system was at the leading edge of current approaches to risk-focussed supervision.

APRA's risk-rating system is complemented by a range of other supervisory tools that have been developed in-house to meet immediate needs. Ideally, this toolkit would ensure a consistent and integrated 'end-to-end' supervision process by which prudential data and other information are received, judgments made, and supervision activities performed and documented (and all in timely fashion). APRA has made the attainment of this ideal a major strategic priority.

In a dynamic and complex financial system, a supervisory toolkit – no matter how well integrated – needs to be in the hands of skilled supervisors. No APRA tool can substitute for mature and incisive supervisory judgment. The need is even more pressing under a principles-based approach where supervisors must be able to assess, in a variety of circumstances, whether the specific solutions proposed by supervised institutions are capable of meeting the relevant prudential principles.

APRA's Executive Group is committed to building and retaining a seasoned, high-quality workforce that is on top of market developments and risk issues, and respected by industry. Progress on this score has been very positive but hard-won. APRA has been able to attract experienced staff from industry and the professions, locally and overseas, and maintains an active graduate recruitment program. At the end of 2006/07, staff numbers were 582, a slight fall over the year but close to target. However, this outcome belies the challenges that have faced APRA in competing for financial and risk management skills that are also highly sought after in the marketplace. APRA's staff turnover continued at around the level of the previous year and with much the same pattern: mobile younger staff but a settled cadre of more senior supervisors.

Additional and welcome funding was provided in the 2007/08 Commonwealth Budget to enable APRA to better attract and retain qualified staff. This funding will help to address salary relativities in areas where APRA remuneration has fallen well behind market, and to bolster APRA's extensive training programs. These measures will reinforce a series of internal initiatives aimed at greater staff motivation and retention, through improvements to management and leadership practices, the distribution of financial rewards, the development of career opportunities and staff recognition. APRA is also expanding its program of secondments to prudential regulators and major financial institutions abroad; however, staff exchanges with local financial institutions, which some see as a way of broadening APRA's experience, remain problematic on confidentiality grounds.

Looking ahead

The current year will see the last major plank of APRA's recent reform agenda fall into place, when the Basel II Framework is introduced. This fundamental reform of regulatory capital for deposit-taking institutions will provide stronger and more accurate management of and pricing for risk – a reward in itself for the investment incurred whatever the individual capital impacts prove to be. Other reform initiatives include conglomerates, refinements to the supervisory framework for general insurance to facilitate the licensing of foreign insurers, and further follow-up on the recommendations of the Regulation Taskforce. This list may seem long but industry can be assured that the hard yards of reform have already been secured.

Beyond its normal supervisory activities, APRA's organisational energies in 2007/08 will be directed at further improving its efficiency and effectiveness. Importantly, APRA has strengthened its strategic focus on its supervisory processes and corporate infrastructure to ensure that their development is not piecemeal – hard to achieve in the formative period of a new organisation – but pursued within a comprehensive, best practice blueprint. As part of this drive, APRA is also reviewing its supervisory cycles and the level of routine

APRA Members in 2006/07 – (left to right) Mr Ross Jones, Dr John Laker and Mr John Trowbridge.

interaction with supervised institutions. APRA's aim is to be well-placed to deal with changing economic currents, minimise unnecessary burdens on supervised institutions and make best use of its valuable staff resources.

In the current environment, financial institutions are facing a level of financial market uncertainty they have not had to confront for some period. At the time of writing, the highly unsettled state of global credit markets was expected to persist, at least until the size and ownership of losses in the US sub-prime mortgage market became clearer and markets determined more prudent and sustainable pricing for risk. Though global market volatility had its origins in poor lending practices and aggressive funding strategies by certain US credit providers, there are lessons for all financial institutions to learn in recent events. Boards and management need to satisfy themselves that risks in current and new ventures and investments are clearly identified and monitored, that incentive structures promote enduring rather than transitory success and that any greater appetite for risk is matched by robust risk management systems, the necessary skills and adequate capital resources.

Our people

Now entering its tenth year as Australia's prudential regulator, APRA is maturing into a vigorous, confident and skilled organisation with an unquestioned commitment to the Australian community. Some staff have been with APRA from the outset and have helped to build the organisation from the ground up; many others have lent their weight to this task over recent years. APRA's staff can be proud of what has been achieved to date, and APRA's Executive Group thanks each one of them for their enthusiasm and support.

Dr John F. Laker
Chairman

2

APRA's supervisory activities in 2006/07

Authorised deposit-taking institutions (ADIs)

Authorised deposit-taking institutions ended 2006/07 in very sound financial condition, after another year of strong balance sheet expansion underpinned by broadly based growth in the domestic economy. Business credit grew at its fastest pace since the late 1980s and housing lending growth, which had been slowing earlier, picked up in the second half of the year. Asset quality remains high by both historical and international standards, although arrears rates on housing lending have continued to rise slowly and signs of stress in a small proportion of borrowers have emerged. Nothwithstanding continued intense competition in both lending and retail deposit markets, the profitability of many ADIs was at record levels. Those same competitive pressures, and a wish to spread costs and risks, encouraged further consolidation among smaller ADIs; two regional banks have also announced plans to merge.

In the first months of 2007/08, greater volatility in global credit and equity markets, triggered by a marked deterioration in credit quality in the US sub-prime mortgage market, has limited the access of some ADIs to wholesale funds, particularly from offshore sources, and pushed up funding costs. ADIs have only minimal direct exposures to the US sub-prime mortgage market but the larger ADIs, over recent years, have relied increasingly on offshore wholesale funding. That said, with strong and diversified balance sheets and prudent management of key risks, the ADI sector is well-positioned to withstand the impact of these global developments, were they to continue.

Credit standards

Credit standards in housing lending have been a major focus of APRA's on-site supervision of ADIs for some time. A particular area of interest has been how ADIs assess the ability of their customers to service their housing loans ('debt serviceability'). During 2005/06, APRA undertook a survey of debt-serviceability criteria used by ADIs, which confirmed that ADIs have materially increased the maximum amount they are prepared to lend to any given borrower. The survey was followed up during 2006/07 by a collection of detailed data on all housing loans approved by a large sample of ADIs during the month of September 2006.

APRA's comprehensive review of debt serviceability has not changed the general assessment that housing lending is a sound asset class for ADIs. Nonetheless, analysis of the detailed data has confirmed that the risk profile of housing loan portfolios has increased somewhat, whether measured in terms of higher loan-to-valuation ratios or debt servicing burdens on borrowers. The use of 'net income surplus' models in place of more traditional lending criteria has led to higher lending against given levels of borrower income. However, the key assumption of these models – that all net income above basic living expenses and other fixed commitments is potentially available to service the housing loan – has not been tested in adverse economic conditions. For this reason, boards and management of ADIs need to ensure that they understand the construction of the debt-serviceability models they are using, the quality of the data inputs, the sensitivity to parameters selected and the performance of the models over time. APRA's review has provided peer group data that enable it to direct its supervisory attention to those ADIs that appear to have the more aggressive lending practices.

Private equity

During 2006/07, a significant increase in activity by private equity funds in Australia, mirroring overseas developments, focussed public attention on a number of aspects of private equity. These included risks to participating financial institutions, the implications for investors and the broader economy, the efficiency of public capital markets and the potential for conflicts of interest. The Council of Financial Regulators (see Chapter

5 of this Report) undertook a review of various aspects of private equity in Australia and published its report in the Reserve Bank of Australia's *Financial Stability Review* in March 2007.

As part of this review, APRA surveyed banks operating in Australia about their exposure to the private equity market. APRA found that these exposures were generally spread across the largest Australian and foreign banks and were subject to appropriate credit controls. In aggregate, private equity exposures amounted to less than three per cent of total loans in the Australian banking system and the exposures were mainly restricted to senior debt with a sound credit rating. The Australian banks most active in private equity funding tend to have a fairly well diversified portfolio of exposures while the smaller institutions have exposures to only a handful of transactions, or none at all. The most active foreign banks operating in Australia tend to underwrite larger amounts than the Australian banks, owing to their larger global distribution networks and balance sheets.

APRA's approach to banks' activity in this area has focussed on ensuring that sound credit risk management processes are in place and that appropriate capital is held against potential losses. Currently, the banks that are most active in private equity have well-developed approaches to credit risk management. APRA would be concerned if smaller, less sophisticated ADIs were venturing into private equity without adequate lending policies and credit risk monitoring processes.

Liquidity risk management

For an ADI, liquidity management – the ability to meet financial obligations as they fall due – is critical both to its continued operation and to the maintenance of stability in the financial system. Since the introduction of APRA's prudential framework in this area almost a decade ago, management of liquidity risk by ADIs has undergone considerable change, the main one being the recourse to a broader range of funding sources, such as offshore credit markets and securitisation, to offset the erosion of traditional retail deposit bases. Wholesale funding is now well embedded in funding strategies of the larger ADIs. Under normal conditions, an ADI is able to operate with large mismatches in the maturity of its assets and liabilities but, as recent global credit market volatility has illustrated, liquidity can easily come under pressure if normal counterparties become defensive. For this reason, liquidity risk management practices of ADIs need to be at the forefront of best practice.

While the new Basel II Framework has focussed attention on credit risk and operational risk measurement and management, liquidity risk has not been subject to the same level of rigorous, systematic analysis. Against this background, APRA decided to undertake a review of its approach to liquidity risk management during 2006/07. This review has included an assessment of the current liquidity risk management practices of ADIs as well as a benchmarking study of liquidity monitoring and supervision techniques of other prudential regulators. The review aims to ensure that APRA's prudential requirements provide a sound and relevant basis for the assessment of liquidity risk management and one that is consistent with good practice globally. The assessment of current management practices has confirmed that a number of ADIs have developed robust stress-testing frameworks that go beyond APRA's specific requirements for managing liquidity.

In May 2007, APRA held a conference on liquidity risk management for industry participants and other regulators to discuss current practices and ongoing developments in liquidity risk management. APRA plans to publish a discussion paper on this topic for industry consultation later in 2007.

During the global credit market turbulence in the first months of 2007/08, APRA substantially stepped up its monitoring of ADIs' liquidity positions. This has involved daily contact with large ADIs and the Reserve Bank of Australia, regular reporting of liquidity positions and funding profiles, and liaison with other market participants and offshore regulators.

Trans-Tasman Council on Banking Supervision

In late 2006, a major milestone in the work of the Trans-Tasman Council of Banking Supervision was reached with the passage of legislation in Australia and New Zealand that will facilitate greater harmonisation and co-operation between the banking supervisors in both countries.

The Council was established in February 2005 with the aim of enhancing co-operation and information-sharing between respective supervisors of trans-Tasman banks; promoting and regularly reviewing trans-Tasman crisis response preparedness relating to events that involve banks common to both countries; and guiding the development of policy advice to both governments. The Council is chaired jointly by the Secretaries to the Treasuries of Australia and New Zealand and also comprises senior officials from APRA, the Reserve Bank of Australia and the Reserve Bank of New Zealand (RBNZ).

The legislation requires APRA and the RBNZ to support each other in the performance of their regulatory responsibilities and to consider the impact of their actions on financial system stability in the other country. The legislative changes comprise:

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

The legislative changes will enable APRA and the RBNZ to afford banks additional flexibility in how they structure their businesses within the trans-Tasman markets, and this is expected to bring compliance cost reduction and efficiency benefits. In the context of these changes, the *Banking Act 1959* was amended to expand APRA's statutory responsibilities beyond the protection of depositors to include the promotion of financial stability in Australia.

The future work program of the Council will include looking at improved co-operation on crisis management, promoting seamless service provision for customers and sharing experiences on improving the quality of insurance regulation.

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

General insurance

The general insurance industry had another year of sound underwriting results in 2006/07, continuing the recent track record of solid profits and strong capital levels. The industry is currently very well capitalised with aggregate capital more than twice APRA's minimum requirement. Claims experience generally remained favourable, although some insurers had significant exposure to storm and water damage in New South Wales and Victoria in June 2007 that weighed on profitability. The Hunter Valley storms and their aftermath have led to insurance claims exceeding $1.2 billion.

Restructuring and consolidation in the general insurance industry continued during 2006/07. The acquisition of Promina by Suncorp was a major development, but there were other transactions including a merger of the two largest medical defence organisations and the amalgamation of their associated insurers. A trend towards ownership stakes by insurers in broking organisations continued, as did the acquisition of some underwriting agencies by insurers.

The industry continues to make good progress in developing robust risk management frameworks and strengthening governance, but there is evidence that the premium cycle has entered a softening phase, particularly for commercial insurances. As last year's Report noted, signs of a softening market in some business lines were then emerging and the trend appears to have continued during 2006/07. While substantial loss leading in premium setting has not been observed, anecdotal evidence of significant price discounting is building. Insurers are also seeking new avenues for growth in gross written premiums, including moving into new insurance classes and new international markets.

APRA will continue to monitor developments in this area and, in its dialogue with boards and senior management, to highlight the dangers of underpricing risk in pursuit of growth in premiums. In its supervisory activities, APRA has been emphasising the importance of strong risk management and pricing disciplines along with the need to monitor claims development trends closely; the benign claims experience of recent years cannot be expected to persist indefinitely.

Financial Condition Reports

As part of its second round of general insurance reforms, APRA introduced the requirement that general insurers have their Approved Actuary provide an annual Financial Condition Report. This requirement applied from 1 October 2006. It is a major initiative by APRA and follows a similar long-standing requirement in the life insurance industry. The Financial Condition Report is an important source of financial information, risk assessment and performance analysis, for both APRA and the institution's board.

It is too early to provide any detailed analysis or industry-wide perspective on the quality and effectiveness of these reports. Nevertheless, APRA is already finding them an outstanding source of analytical information, and informal feedback suggests that many boards have also found them to provide valuable insights into their institutions.

Reinsurance and contract certainty

Another of the initiatives in APRA's second round reforms that came into effect in 2006 is the requirement for insurers to have placing slips or cover notes for all their reinsurance arrangements within two months of inception of their reinsurance treaties and to have full contract wordings signed within six months.

This requirement, which also now has a parallel in the London insurance and reinsurance markets, has had the effect of remedying a widespread and sub-standard practice of the Australian general insurance industry, and has had a powerful effect on reinsurance administration. Once it became clear that APRA would introduce the requirement, industry practice changed rapidly and compliance has proceeded very smoothly and to a high standard, with a beneficial outcome for all parties.

National Claims and Policies Database

The third set of reports from the National Claims and Policies Database (NCPD), covering the year 2006, was released in September 2007. These aggregate industry reports include data on claims and policies submitted by all APRA-regulated general insurers providing public and product liability insurance or professional indemnity insurance. The reports give an indication of trends in the levels of premiums and claims costs across the industry, at a national and state level.

Now that three full years of data are available, analysis and trend information from the data are becoming more meaningful. For example, the 2006 reports include for the first time some cohort analysis of claim numbers and claim finalisations.

APRA has also been working with industry to develop additional NCPD reports that will enable more detailed analysis to be undertaken by risk factors such as occupation groups and variations to product or policy coverage.

The NCPD is funded primarily by entities that contribute to it. The 2006/07 year was the first year in which NCPD costs were recovered by a specific levy on contributors as part of APRA's normal annual levy process.

Life insurance and friendly societies

The life insurance industry experienced sound growth during 2006/07 and the profitability and financial position of the industry remain strong. Revenue growth from superannuation business was supported by favourable investment markets and risk insurance premiums continued to show healthy growth. However, the growth in life insurance assets over the year was lower than the growth of total superannuation assets.

Superannuation contributions to life insurance companies continue to be overshadowed by contributions to other superannuation vehicles, causing some further decline in the market share of the life insurance industry in superannuation.

Consolidation within the life insurance industry has continued, largely through intercompany rationalisation of APRA licences and some acquisition activity. Consolidation and rationalisation are also features of the friendly society industry, particularly among smaller societies facing challenges in attracting new members and maintaining sufficient resources to meet ongoing business needs. One friendly society has recently demutualised so that it can focus on business activities outside the benefit fund structure and other societies are also investigating new business lines. Those societies offering educational and prepaid funeral products continue to enjoy the strongest growth.

Over recent years, unit pricing issues have been a recurring problem in APRA's supervision of the life insurance and superannuation industries. The release of *Unit Pricing – Guide to good practice*, published jointly by APRA and the Australian Securities and Investments Commission (ASIC) in November 2005, has been a catalyst for improvements in the risk management and control framework for unit pricing. Nonetheless, unit pricing problems continue to emerge, partly as a result of company acquisitions producing multiple administration systems that are difficult and expensive to integrate. Compensation for unit pricing errors by APRA-regulated institutions has been substantial. At the same time, however, remediation efforts have led to more robust unit pricing, administration and risk management in many institutions.

Governance arrangements in the life insurance industry have improved, with stronger processes by some life companies to meet the requirement that policyholder interests be given priority over shareholder interests.

Legacy products and systems

The difficulty in rationalising legacy products, which have become increasingly difficult and costly to support, has been a recurring problem for the life insurance and superannuation industries. In response to recommendations of the Taskforce on Reducing Regulatory Burdens on Business, the Treasury published an issues paper in June 2007 covering product rationalisation across the life insurance, superannuation and managed investments industries. This will be followed by an options paper that will also be subject to formal consultation. APRA welcomes this progress, including recognition in the issues paper that any mechanism for rationalising products must not weaken protection for life insurance policyholders and superannuation fund members.

In its dealings with industry, APRA continues to stress that any improvements in the mechanism for rationalisation of legacy products need to be accompanied by industry efforts to limit the complexity of future products. That said, providers of life insurance and investment products continue to compete for market share through product differentiation that involves adding more features to products. This can perpetuate the problem of products that become, over time, unnecessarily complex and costly to administer.

Risk insurance, claims and underwriting

Over recent years, a significant trend in risk insurance has been the move from individual (retail) insurance to group insurance, generally provided as a benefit of a superannuation fund. This trend, which is expanding the coverage of life insurance across the Australian population, has been accompanied by strong competitive pressure on the pricing of both individual and group insurance. In this environment, APRA continues to emphasise to institutions the importance of robust pricing and risk management processes.

APRA has been in discussion with industry over the lack of experienced staff in life insurance underwriting and claims management. Over the last few years the increased focus of the industry on superannuation business has meant less attention being given to developing underwriting and claims management skills. This has led to a skills shortage that is affecting the quality of the decisions that are being taken in these critical areas. APRA has been encouraging institutions to put more effort into company and industry training programs to increase the available resource pool.

The recent introduction of automated underwriting processes by many institutions is a positive development for the industry, although the effect on pricing for mortality and morbidity will not be known for some time. These processes should improve the efficiency of underwriting but will not reduce the need for appropriately trained and experienced underwriting staff to manage the more complex underwriting decisions.

Experience studies

The competitive pressure on individual and group insurance is also occurring at a time when the life insurance industry is not well equipped to measure the underlying mortality and morbidity experience across the industry. Some institutions have ceased contributing to industry experience studies or are producing inadequate data, and the consequence can be a misunderstanding of the underwriting risks being assumed. APRA has been encouraging the industry to improve the quality and timeliness of mortality and morbidity experience studies and, should this not occur, APRA may have to consider becoming directly involved in the collection of such data.

Superannuation

The superannuation industry received a major fillip in 2006/07 from high investment returns and, in particular, record inflows following the Government's 'Better Super' reforms. APRA's major supervisory focus, over the first full year of the new superannuation licensing regime, was the implementation of the risk management requirements and other operating standards that were introduced as part of the licensing regime. APRA was also active in finalising the transfer of member benefits and the winding-up of funds where trustees decided to exit the industry.

Superannuation licensing

The new superannuation licensing regime began on 1 July 2006 with 307 trustees with Registrable Superannuation Entity (RSE) licences and 6,885 registered superannuation funds, comprising 612 funds with more than four members and 6,273 Small APRA Funds. After a period of intense industry consolidation leading up to and during the licensing transitional period, the number of licensed trustees and registered funds has shown little change.

The trustees of around 800 funds did not apply for an RSE licence and, of these, 186 trustees had not finalised alternative arrangements for the entities under their trusteeship by 30 June 2006. APRA appointed acting trustees to six funds whose trustees had not taken sufficient action to transfer members. The remainder of the 186 trustees entered into formal undertakings with APRA to finalise alternative arrangements within a reasonable timeframe. By end June 2007, formal undertakings with only seven trustees (representing eight funds) remained outstanding.

Supervisory activities

Under the new licensing regime, trustees are required to have appropriate risk management systems, meet a fitness and propriety standard, have adequate financial, technical and human resources to conduct their operations and, where material business activities are outsourced to service providers, have written agreements with these providers that meet prescribed conditions. During its supervisory reviews, APRA has been assessing whether what was provided by trustees in written policies in their licence application reflects actual practice and whether these policies are commensurate with the business strategies of the trustee and responsive to changing market conditions and legislative requirements. APRA's preliminary assessment after the first year of the new regime is that there is still some way to go, across the industry, in implementing risk management structures and practices appropriate to the actual circumstances of funds. This parallels the experience of the general insurance industry which, after its re-licensing in 2002, faced a steep learning curve in implementing enhanced risk management requirements.

Some of the risk management issues APRA has been addressing with trustees include ensuring the actual risks of the trustee and fund operations are identified, built into the trustee's risk management documentation and dealt with appropriately in practice; recognising and dealing with actual and potential conflicts of interest through the use of appropriate risk controls or avoidance; and liquidity management in the context of the removal of maximum benefit limits and the reduction in the maximum timeframe for transfers under revised portability rules.

Outsourcing

Superannuation is characterised by a high level of outsourced service provision. APRA has been reviewing trustees' contract management, including their due diligence processes and the monitoring of service providers. The new operating standard on outsourcing gives APRA greater access to key service providers; reviews of these providers, involving on-site visits by APRA's specialist risk staff, will commence in 2007/08. Given the concentration of service providers in the superannuation industry, APRA will achieve operational efficiencies by applying the findings from these reviews across the range of trustees that use these providers.

Investments and operational risk

Operational risk is a major inherent risk of superannuation funds because of their large volume of transactions and the need to keep accurate records of entitlements over long periods of time, whether the fund delivers investment returns through unitisation or through crediting rates. Errors in one financial year can be easily compounded across subsequent years.

APRA does not have a philosophical position in favour of either unitisation or the use of crediting rates, since trustees that use crediting rates to distribute investment returns face substantially the same issues and risks. The frequency with which trustees determine unit prices or crediting rates should be suitable to the member activity within the fund. In its supervisory activities, APRA has been assessing the reasonableness of the crediting rate and unitisation methodologies adopted by trustees and how well these work where investment choice, fund choice and portability of benefits give rise to *ad hoc* transactions, sometimes involving large amounts.

APRA has also been reviewing the implementation of investment strategies for member investment choice and the risk mitigants which support those strategies. Investment in alternative and unlisted assets has been increasing in a search for yield and trustees need to apply appropriate due diligence, both before entering into these investments and in their ongoing valuation for the purpose of distributing investment earnings to members.

Eligible Rollover Funds

APRA is aware of a number of emerging issues concerning the operation of Eligible Rollover Funds (ERFs), including conflicts of interest (e.g. investing in products offered by referring institutions), investment strategies that may not be suited to members, the process a trustee uses to select an ERF, and monitoring of lost members accounts and the approach to account consolidation. APRA considered these issues during the superannuation licensing process and a further review is under way.

Supervision of sub-funds

A by-product of consolidation in the superannuation industry is the proliferation of sub-funds. Many previously stand-alone corporate funds have converted under the successor fund provisions to become sub-funds of master trusts or of industry funds. This is not an unexpected development. APRA has been working with trustees to assist them in understanding and effectively managing the risks presented in particular by defined benefit sub-funds. APRA is also reviewing the application of actuarial reporting requirements in the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to ensure that funding and solvency certifications, remediation and wind-up requirements for technical insolvency and ongoing actuarial reporting all operate effectively at a sub-fund level. APRA will be consulting industry on this during 2007/08. APRA expects its annual prudential returns will be amended to better cater for sub-funds when the returns are next reviewed.

Pandemic planning

Increasing instances of avian influenza have heightened concerns about a potential human influenza pandemic. The World Economic Forum has rated the threat of such a pandemic as one of the most serious risks facing the global economy. While not wanting to overstate the likelihood of a pandemic in Australia, APRA has been working with industry and Government to ensure that Australia's financial system is able to cope with the potential impact. APRA's interest is ensuring that regulated institutions have taken prudent and reasonable precautions to enable them to continue operating and meet their core obligations to depositors, policyholders and other beneficiaries.

Over the course of 2006, APRA met with major banks, insurance companies and industry associations to gather information on how pandemic risks were being addressed. On the basis of these discussions, in October 2006 APRA released an information paper and a prudential practice guide to assist APRA-regulated institutions with their planning for a potential pandemic. The guide summarises the considerations and better practices APRA observed at those financial institutions that were, at that time, more advanced in developing their pandemic approaches. It outlines key aspects of pandemic plans and how pandemic planning differs from traditional business continuity planning, critical financial sector functions in a pandemic, and external factors that need to be considered. It also discussed modelling financial impacts of a pandemic.

During 2006/07, APRA also undertook a stress-testing exercise involving general insurers, life insurers and friendly societies to gauge the potential financial impacts of a pandemic. All institutions active in business lines that could potentially experience higher claims in a pandemic participated in the exercise. Institutions estimated claims and projected their financial position on a consistent basis according to a set of scenarios provided by APRA covering varying infection and mortality rates and other parameters. The stress test provided APRA and insurers with a general indication of the level of severity of a pandemic that could begin to cause financial difficulty for different segments of the insurance industry. APRA and the industry can now incorporate this information into their own pandemic planning efforts.

APRA is encouraged by the co-operative approach being taken to pandemic planning and believes that the Australian financial system is well advanced relative to other sectors and countries. The Australian deposit-taking and insurance industries have been proactive and timely in addressing pandemic risks to ensure that regulated institutions can continue to provide essential services to the public even in very difficult circumstances and, in the case of insurers, to understand and manage the insurance risks involved.

APRA has also undertaken its own pandemic planning exercise. APRA's pandemic plan focuses on its role in maintaining confidence in financial institutions and in supporting financial stability. The plan ensures that APRA is well-placed to meet its obligations under the *Commonwealth Government Action Plan for Human Influenza Pandemic*. APRA has also taken a number of practical protective measures and is developing contingency arrangements to support its pandemic planning.

Enforcement activities

From time to time, APRA takes enforcement action against individuals and supervised institutions where this is necessary to protect the interests of depositors, policyholders and members of superannuation funds (APRA's 'beneficiaries'). APRA may also take action to prevent unregulated entities from conducting business which can only lawfully be conducted by an authorised financial institution.

APRA's approach is to seek to work co-operatively with boards and management of supervised institutions to resolve issues that are likely to impinge on the ability of an institution to meet its financial promises. On occasions, however, APRA's cooperative approach will be unsuccessful either because the institution is not willing to cooperate or is unable to do so. Under these circumstances, it is critical that APRA take prompt enforcement action under the legislation it administers to safeguard the interests of beneficiaries. The enforcement actions available to APRA are to instigate investigations into the affairs of supervised institutions and appoint inspectors, disqualify persons and organisations from participating in the management of supervised institutions, issue directions to the institutions and accept enforceable undertakings. APRA can also take criminal actions against persons and institutions or seek restraining orders. In April 2007, the Government announced its decision to introduce a court-based process for decisions to disqualify individuals under APRA-administered legislation, similar to the disqualification framework used by ASIC. Legislation to give effect to this decision is currently before the Parliament.

Where possible, APRA publicises its enforcement actions. Widespread publicity communicates to boards and management the minimum standards of behaviour that APRA considers acceptable from supervised institutions and their responsible persons, and enhances public confidence in the integrity of the financial system.

During 2006/07, APRA undertook 159 enforcement actions. This is substantially less than the previous year, when APRA accepted enforceable undertakings from a number of trustees of superannuation funds that were exiting the industry but had not finalised the transfer of member benefits and the wind-up of the fund. As noted in last year's Report, the enforcement workload now tends to involve a smaller number of more complex cases and, at times, vigorous legal challenges to its actions; such cases can consume substantial time and resources.

APRA has continued its enforcement activity relating to the failure of HIH Insurance. A number of HIH matters were stayed during 2006/07 pending a High Court decision on APRA's jurisdiction to disqualify overseas-based individuals from acting in a senior management role in an Australian insurer, and on APRA's use of evidence presented to the HIH Royal Commission. In February 2007, the High Court decided both matters in APRA's favour and the previously stayed matters were reactivated. Two further disqualifications related to HIH Insurance have been made.

During the year, APRA concluded its investigation into a set of improper financial reinsurance transactions entered into by General Reinsurance Australia Limited (GRA), the Australian subsidiary of General Reinsurance Corporation, between 1997 and 2001. The report of the industry expert appointed by APRA to act as Inspector was released to GRA after obtaining the Attorney-General's advice and an excerpt was released in the public interest. The Inspector found that GRA engaged in 'questionable behaviour' in knowingly issuing financial reinsurance contracts to certain insurance companies that enabled those companies to falsely state their profits and/or solvency position. The companies concerned were Zurich Australian Insurance Limited, FAI Insurance Group and New Cap Reinsurance Corporation Ltd. Following the investigation, APRA imposed a condition on GRA's authorisation that requires it to maintain a majority of independent directors on its local Board. APRA has disqualified a total of 16 individuals involved in these improper financial reinsurance transactions, accepted an enforceable undertaking from one other person and is considering potential enforcement action in other cases. Five of the disqualifications are under review by the Administrative Appeals Tribunal (AAT).

In the superannuation industry, the accountant of Western Truck Superannuation Fund was disqualified for having falsified the accounting records and tax returns of that Fund. The directors of the Firezone Protection Services Superannuation Fund were disqualified because the trustee improperly appropriated money from the

Fund for use by the employer sponsor. The accountant and auditor of Wall and Ceiling Superannuation Fund were each convicted in the County Court of Victoria on charges of intentionally entering into or carrying out a scheme to deceive APRA. The scheme involved backdating unit trust deeds and falsifying accounting records to avoid the operation of the in-house asset rules in relation to investments in purpose-built commercial factories leased to the employer sponsors.

In the banking area, APRA obtained orders in the Federal Court preventing an unauthorised financial business, the 'Federal State Bank of Australia' from calling itself and acting like a 'bank'. The court accepted evidence that hundreds of thousands of dollars in fake currency and cheques were being passed off as legitimate and that the word 'bank' had been used illegally. APRA has also been investigating the unregulated entity Terra Nova Cache, established and managed by Mr David Siminton, self-proclaimed Governor of the 'Principality of Camside' in South Yarra, Victoria. APRA alleges that Mr Siminton has been conducting unauthorised retail 'banking' through Terra Nova Cache. APRA obtained court orders freezing assets and prohibiting Mr Siminton, who is an undischarged bankrupt, from conducting banking business. Mr Siminton was subsequently convicted for contempt of court. Judgment in the main case seeking to restrain Mr Siminton or Terra Nova Cache permanently from breaching the *Banking Act 1959* has been reserved.

Over the five years to 30 June 2007, APRA has removed by disqualification or enforceable undertaking:

- 81 senior personnel in superannuation (another 13 were disqualified, but had their disqualifications overturned under internal or AAT review);
- 37 senior personnel in general insurance (another three individuals were disqualified but had their disqualifications overturned on internal review). In all but six cases, the disqualifications applied to individuals involved with events leading up to the failure of HIH Insurance; and
- one senior person in the credit union industry and one senior person in the friendly society industry.

Eleven disqualified individuals have appeals under way in the AAT.

Enforcement actions[1]

	ADIs		Super-annuation		General insurance		Life insurance		Friendly societies		Other[2]		**Total**	
	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**
AAT/Federal Court review			13	**1**	3	**5**						**1**	16	**7**
Amendment of IOA[3]			1										1	**0**
Appointment of Acting Trustee			1	**11**									1	**11**
Appointment of liquidator/Inspector													0	**0**
Civil litigation		**3**	3	**3**	1	**2**					3	**4**	7	**12**
Directions and contravention notices			2	**4**	2						6	**17**	10	**21**
Disqualification of auditors/directors	1		22	**7**	12	**6**				**1**	1	**2**	36	**16**
Enforceable undertaking			164		1								165	**0**
Follow-up delayed contributions			8	**18**							1		9	**18**
Investigation action	1		7	**4**							3	**4**	11	**8**
Other action	4	**3**	8	**26**	4	5					10	**3**	26	**37**
Prosecution		**1**		**2**							1		1	**3**
Refer to other agency/police		**3**	9	**6**	3	1					3	**3**	15	**13**
Removal of trustee/ withdrawal of IOA/ revocation			1		3								4	**0**
Show cause letter	2	**1**	52	**11**	7	1	**1**						62	**13**
Total	**8**	**11**	**291**	**93**	**36**	**20**	**1**	**0**	**0**	**1**	**28**	**34**	**364**	**159**

1 Year ending 30 June.

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

3 Instrument of Approval.

3

The prudential supervision framework

APRA's agenda to strengthen the prudential supervision framework in Australia, a major priority over the past few years, came closer to completion during 2006/07 with the release of new prudential standards on outsourcing, capital adequacy for general insurers and risk management and business continuity management for life insurers and friendly societies. The new Basel II Capital Framework, now nearing its implementation date, also continued to receive considerable attention. Any prudential supervision framework must remain responsive to changing market and industry circumstances, but further substantial reforms are not currently envisaged. Australia's prudential supervision framework received strong endorsement during the year from the International Monetary Fund (IMF) under its Financial Sector Assessment Program.

In its *Statement of Intent*, APRA has confirmed its commitment to a supervisory approach that is focussed on outcomes. This has two main and complementary elements:

- a 'principles-based' approach to prudential regulation that recognises the complexity and diversity that exists among financial institutions; and
- a 'risk-based' approach to the supervision of individual institutions that ensures supervisory attention and resources are directed to institutions whose activities are posing greater risks (discussed in the following Chapter).

Over the past couple of years, new prudential standards introduced by APRA have, where possible, moved to being more principles-based. In brief, a principles-based prudential framework is one that emphasises outcomes in setting regulatory requirements and expectations, but does not seek to specify or prescribe the exact manner in which those outcomes must be achieved. Such a framework provides regulated institutions with greater flexibility in meeting prudential requirements and avoids one-size-fits-all rules that do not discriminate suitably by the size, complexity or risk profile of individual institutions. One example of this principles-based approach is APRA's prudential standards on the fitness and propriety of 'responsible persons'. The standards outline high-level criteria to determine if a person is fit and proper and they require that regulated institutions have their own policies, and take all prudent steps, to ensure their responsible persons meet those criteria. Each institution is allowed to develop its own checks and methods for making these judgments. Another example is the high-level principles in APRA's prudential standards on governance that boards assess their performance on a regular basis and ensure that they remain open to new ideas and independent thinking. The governance standards do not prescribe how institutions must satisfy these principles. Rather, APRA now provides non-binding guidance on these and other principles through prudential practice guides. These guides aim to assist institutions understand APRA's expectations and outline a range of acceptable practices and approaches. Institutions can employ any of those practices or an alternative that is consistent with their business objectives, so long as it delivers the prudential outcome APRA is seeking.

In APRA's view, the combination of a principles-based prudential framework and a risk-based supervisory methodology should lead to cost-effective outcomes, both for regulated institutions and for APRA, that minimise the impact on the dynamics and further development of the Australian financial system. For regulated institutions, the approach should help to minimise regulatory burden by allowing them more flexibility in meeting prudential requirements. For APRA, the approach allows supervisory expertise and resources to be deployed on the more pressing risk problems and greater use to be made of supervisory judgment to produce sensible, rather than simply 'compliant', outcomes.

A supervisory approach focussed on outcomes is not without its challenges, however. For one thing, there are areas of the prudential framework that do not lend themselves to a principles-based approach. In particular, capital adequacy requirements – a fundamental plank on which the prudential framework is built – are by necessity prescriptive: these must be clear and applied consistently so as not to generate unnecessary debate about whether they are met, or to grant any material competitive advantage to one institution over another. For another, principles-based regulation provides flexibility at the cost of certainty. Under a prescriptive set of rules, regulated institutions have clarity as to what they must do to meet prudential requirements, but little room for compromise or alternative approaches. A principles-based approach provides greater scope for institutions to design their business arrangements and risk management systems according to their particular circumstances, rather than ticking a checklist; at the same time, institutions need to explain their approach and accept APRA's judgment as to the adequacy of their systems and controls. The increased emphasis on supervisory judgment, in turn, puts demands on the quality and experience of supervisory staff.

A third challenge is achieving an appropriate balance between consistency of decision-making and risk-based supervision. It is important that the judgment of one supervisor, looking at a given set of facts, be similar to that of another supervisor presented with the same set of facts. APRA has taken a number of steps in recent years to improve the consistency of its supervisory decisions, including requiring supervisors to seek advice from expert areas in APRA for certain decisions and centralised decision-making for others. At the same time, a risk-based approach requires supervisors to judge each situation on its merits and different institutions may find that they get different responses on the apparently same issue. A request for a particular prudential treatment on an issue, for example, will be assessed differently when received from a well-managed institution with a strong risk management framework compared with another institution with weak management and controls. This should not be seen as a sign of inconsistency in decision-making but, rather, a willingness by APRA to look at a given situation holistically and respond in a manner that has regard to the risk profile of the institution and the overall outcome APRA is seeking. In this context, open dialogue between APRA and regulated institutions about the basis for APRA's judgments is essential, and something APRA is keen to encourage.

Harmonised prudential standards

As an integrated prudential regulator, APRA is committed to harmonising its prudential standards across APRA-regulated industries, where appropriate. Given that an increasing number of conglomerate financial groups in Australia have operations in more than one of these industries, a harmonised approach improves the integrity and efficiency of the prudential framework; there is, after all, no logical reason why behavioural standards, in particular, should differ across the industries. During 2006/07, harmonised prudential standards for 'fit and proper' and governance came into effect, a new outsourcing standard was released and new standards on risk management and business continuity management for life insurers and friendly societies brought these industries into line with other APRA-regulated industries.

Fit and proper

APRA's prudential standards on the fitness and propriety of 'responsible persons' of ADIs, general insurers, life insurers and friendly societies came into effect from 1 October 2006. They were accompanied by separate prudential practice guides. The standards establish minimum benchmarks for acceptable practices for appointments to positions of responsibility and, as noted above, place the onus for judgments about fitness and propriety squarely on the regulated institutions themselves.

Where practicable, APRA has harmonised its fit and proper requirements with ASIC's fit and proper regime for responsible officers. The Taskforce on Reducing Regulatory Burdens on Business recommended that the APRA and ASIC regimes be reviewed with a view to achieving greater consistency. A joint APRA/ASIC working group responding to the Taskforce (and discussed in Chapter 5) has found that there is not a large overlap of responsible positions covered by both regimes; nonetheless, existing reporting requirements will be clarified to ensure that institutions are not reporting unnecessary information to both APRA and ASIC.

Governance

APRA's prudential standards on governance, and associated prudential practice guides, also came into effect from 1 October 2006. The standards set out minimum foundations for good governance of APRA-regulated institutions and brought APRA's previous governance requirements in line with what has become accepted in Australia as good practice in corporate governance. In developing its standards, APRA aligned its requirements and definitions, where possible, with the *Corporations Act 2001* and with the Australian Stock Exchange (now Australian Securities Exchange) Corporate Governance Council's *Principles*.

At the time it released the standards, APRA noted that it had the flexibility to respond to genuine concerns from institutions that believe they have sound reasons for not meeting a specific requirement. In that spirit, a number of institutions sought and were granted either longer transition periods to meet various requirements or exemptions from requirements. The exemptions responded to the unique circumstances of particular institutions or groups of institutions (mainly captive insurers) and were granted where institutions could demonstrate to APRA's satisfaction that they had alternative arrangements that were consistent with the objectives of the governance standards.

Outsourcing

In October 2006, APRA released new and harmonised prudential standards on managing risk from outsourcing. These standards adopted a principles-based approach detailing APRA's minimum outsourcing requirements but leaving the way open for institutions to develop their own outsourcing policy in a way that meets the principles. The standards allow institutions greater flexibility in their approach to intra-group outsourcing and deal explicitly with outsourcing to an offshore party ('offshoring'). On the latter point, regulated institutions must consult with APRA prior to entering into a material offshoring contract but APRA will not be approving individual arrangements.

The outsourcing prudential standards took effect on 1 April 2007.

Risk management and business continuity management

In October 2006, APRA released a discussion paper and draft prudential standards and guidance on risk management and business continuity management for the life insurance and friendly society industries. The package aimed to establish APRA's minimum expectations in these areas and to bring a number of prudential requirements for these industries into line with other APRA-regulated industries. Final prudential standards, developed in consultation with industry, were released in March 2007, together with a number of prudential practice guides on various aspects of risk management, asset and liability management, conflicts of interest and reinsurance management. The two new standards, which come into effect from 1 January 2008, also replace a series of existing, but dated and prescriptive standards for friendly societies.

New Basel Capital Framework

During 2006/07, further substantial progress was made towards the implementation of the Basel II Framework in Australia. This new capital adequacy regime for deposit-taking institutions is a major global initiative designed to harness best practices in risk management into the regulatory process and provide more risk-sensitive capital requirements. The Basel II Framework will come into effect in Australia from 1 January 2008 through APRA's prudential standards. Preparing for this implementation has required a significant commitment of APRA resources since the Basel Committee released its original proposals in 1999, and particularly over the past three years.

The great majority of Australian banks, building societies and credit unions will use the standardised Basel II approaches in determining their regulatory capital charge. The Basel II capital adequacy requirements that will apply to most of these ADIs relate largely to credit and operational risk. Some changes to risk management and reporting systems will be required for ADIs using the standardised approaches but the changes should not be onerous.

ADIs wishing to adopt the more sophisticated approaches available under Basel II must be accredited by APRA. Those Australian-owned ADIs wishing to be accredited from January 2008 applied to APRA in September 2005. There are no subsidiaries of foreign-owned banks seeking full accreditation from January 2008.

APRA expects that around a dozen larger Australian banks and subsidiaries of internationally operating banks will eventually be accredited to use the advanced Basel II approaches. In aggregate, these banks would represent a substantial majority of total ADI assets. Once accredited, they will be able to use their own quantitative risk estimates as inputs into their regulatory capital charge, rather than apply the supervisory rules of the standardised approaches. Given the importance of capital in maintaining the financial strength of an ADI, as well as market and public confidence in the institution, APRA believes the accreditation process must be robust. In their applications, ADIs must undertake a detailed self-assessment of their compliance with the Basel II rules and address a number of other requirements that would demonstrate the extent to which the use of their own risk-based capital and associated risk-adjusted performance measurement permeates the management of the ADI's business. APRA also requires that each ADI's application be signed off by its board.

ADIs' preparations for the advanced Basel II approaches have been demanding, in terms of resources, data and time, and those preparations have not ended with the applications. Applicants are continuing with their risk modelling work, with some substantially reviewing their systems and models to ensure that their quantitative risk estimates meet the stringent initial and on-going Basel II requirements. For its part, APRA has analysed the details of the applications and is undertaking on-site reviews and benchmarking exercises. For those banks seeking accreditation from January 2008, APRA expects to make its determination in late 2007.

During 2006/07, APRA released six revised draft prudential standards relating to Basel II (some being second round revisions) and released a further seven in the first quarter of 2007/08. APRA has now released its proposed approach to Pillar 1 (minimum capital requirements), Pillar 2 (supervisory review process), Pillar 3 (market disclosure) and the associated draft prudential reporting standards. In all, consultation documents on ten prudential standards and the associated reporting standards have been issued over the past fifteen months, continuing an extensive consultation process on the Basel II Framework since 2004. APRA expects to determine the final Basel II prudential and reporting standards in late 2007.

Quantitative impact studies undertaken by the Basel Committee had earlier suggested that Australian ADIs seeking accreditation to use the advanced Basel II approaches could have a larger reduction in minimum regulatory capital levels than in many other countries. That, at least in part, reflected the larger proportion of housing loans on the books of Australian ADIs compared to their overseas peers; in Australia's case, as well, the data on credit risk were reflective of a benign part of the economic cycle. During 2006/07, APRA's accreditation process identified a number of areas in which applicants were making assumptions that in APRA's view were not sufficiently robust to any eventual downturn in the economic cycle. This has generally been accepted by applicant banks. They have now adopted more conservative assumptions in their capital models, which will considerably narrow the likely reductions in minimum regulatory capital levels compared to earlier expectations. In any event, reductions in regulatory capital for banks accredited to use the advanced Basel II approaches, relative to what would have applied had the current Basel Capital Accord remained in place, will be limited to 10 per cent in 2008 and this limit will be retained in 2009 pending a review of experience with these approaches.

During 2006/07, APRA conducted a separate quantitative impact study involving 12 representative ADIs that will be using the standardised Basel II approaches. This study indicated that, in general, adopting the standardised approaches will lead to a modest reduction in regulatory capital requirements. Under the Basel II Framework, no limit on capital reductions applies to this group.

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

General insurance reform

Major elements of APRA's second round of general insurance reforms were completed when three new prudential standards, dealing with risk management, reinsurance management, and audit and actuarial reporting and valuation, came into effect from 1 October 2006. The standards include requirements for a rigorous business plan addressing the insurer's ability to meet future capital requirements; an annual declaration on the accuracy and completeness of financial information; documentation of reinsurance arrangements including a reinsurance arrangements statement; prior approval of limited risk transfer arrangements; and preparation of an annual Financial Condition Report on each insurer by its Approved Actuary. With these reforms in place, there remains only one recommendation of the HIH Royal Commission referred to APRA that is still outstanding and it deals with the supervision of conglomerate groups involving general insurers (see below).

In September 2006, after extensive industry consultation, APRA released new prudential standards on capital requirements for general insurers that aligned the general insurance prudential framework with International Financial Reporting Standards (IFRS). The standards decoupled the definition of Tier 1 capital instruments and the assessment of securitised assets for capital adequacy purposes from Australian Accounting Standards; they also introduced new definitions of Tier 1 capital instruments and new limits on Tier 1 capital. These changes were consistent with the changes earlier introduced for ADIs and covered the nature and classification of capital, not its quantum. The standards came into effect from 1 January 2007.

Conglomerates

In October 2006, APRA released a paper setting out its response to industry submissions on its proposed approach to the prudential supervision of conglomerate groups involving general insurers. APRA's proposed approach, set out in a discussion paper in May 2005, was focussed on contagion risk: the risk that adverse developments in activities conducted by other group members could affect the soundness of the regulated insurer (or insurers) in the group. The proposed approach envisaged a three-level supervision framework for general insurance groups.

Submissions on the proposals were clouded by fears that APRA's approach to group supervision would be accompanied by burdensome reporting requirements. In response to these concerns, APRA elected to prepare, after informal industry consultation, a separate discussion paper on proposed reporting requirements for consolidated general insurance groups. This paper was released in August 2007. The proposed group reporting requirements involve a significant reduction in the level of data collected compared with individual APRA-authorised insurers, and a lower frequency of collection, without compromising APRA's ability to undertake consolidated group supervision.

Rather than a three-level supervision framework, APRA is now proposing a staged implementation of corporate group supervision. APRA will continue to supervise individually authorised general insurers (Level 1 supervision) and proposes to supervise the general insurance group, including all general insurers in the group, on a consolidated basis (Level 2 supervision). The APRA approach is intended to ensure that the minimum capital requirements for consolidated general insurance groups are equivalent to those of stand-alone APRA-authorised insurers. Level 3 supervision, which will take into account all entities within the group, including any entities not authorised by APRA, will be developed later on a cross-industry basis.

After further consultation, APRA intends to release the full package of draft prudential standards and reporting standards for Level 2 insurance groups in late 2007.

Direct offshore foreign insurers and discretionary mutual funds

In response to the concerns of the HIH Royal Commission about the operation of direct offshore foreign insurers (DOFIs) and discretionary mutual funds (DMFs), which are not regulated by APRA, the Government commissioned a review of DOFIs and DMFs in September 2003. In 2005 and 2006, the Treasury conducted rounds of consultations on the recommendations from this review; APRA worked closely with the Treasury during this process.

In May 2007, the Government announced a package of reforms to enhance the integrity of the general insurance industry. Under the reforms, DOFIs will become subject to APRA's prudential regulation through amendments to the *Insurance Act 1973* that will extend the definition of 'carrying on insurance' in Australia. There will be some limited exemptions where the capacity of the Australian insurance market does not meet the full needs of large or specialised buyers of insurance.

DMFs will not be subject to prudential regulation at this stage but will be required to provide data to APRA. This will assist the Government to review DMFs within three years from the start of the data collection to determine whether they warrant prudential regulation.

To give effect to the Government's reforms, APRA released a discussion paper in July 2007 on proposed refinements to the general insurance prudential framework, applying not only to DOFIs but to all APRA-authorised general insurers. This paper was prepared after a number of informal discussions with key stakeholders, including APRA-authorised insurers, insurance agents, brokers, large corporations and DOFIs. The paper proposes refinements to the prudential framework that will clarify how APRA exercises judgment in the application of the framework to different categories of APRA-authorised insurers. These refinements are expected to deliver, among other things, a more hospitable environment for smaller insurers and for captives, as well as a clearer position for foreign insurers, whether branch, subsidiary or reinsurer.

Amendments to the *Insurance Act 1973* were passed by the Parliament in September 2007. Subject to consultations, the proposed refinements to the prudential framework will apply from 1 July 2008. APRA's proposals on data collection from DMFs will be addressed in a separate discussion paper to be released later in 2007.

Life insurance reforms

Streamlining Prudential Regulation

The report of the Taskforce on Reducing Regulatory Burdens on Business (April 2006) and the Government's response, *Streamlining Prudential Regulation: Response to 'Rethinking Regulation'* (December 2006) had particular implications for the prudential regulation of life insurers and friendly societies. The Government noted that the *Life Insurance Act 1995* (Life Act) had not been significantly modernised to reflect APRA's approach to prudential regulation over recent years and remained more prescriptive and less flexible than the legislation applying in the ADI and general insurance industries. The Government's proposals paper identified a number of areas where it considered the Life Act could be simplified and made less prescriptive and, in so doing, ensuring that APRA has appropriate flexibility to modify prudential requirements for life insurers and friendly societies.

Following consultations, the Government introduced the Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007 into Parliament in June 2007. The amendments relevant to prudential regulation of life insurance and friendly societies include:

- removing certain prescriptive provisions from the Life Act that are better placed in APRA's prudential standards;
- simplifying the appointment processes for auditors and actuaries (such that a life insurer may appoint its own auditor and actuary subject to meeting APRA's fit and proper prudential standard). APRA will no longer approve auditors or actuaries; and
- transferring to APRA the responsibility for setting standards in relation to actuarial matters, including capital adequacy and solvency, from the Life Insurance Actuarial Standards Board, which will cease to exist from 1 January 2008.

In August 2007, APRA released a consultation package confirming its intention to maintain an unchanged prudential framework in light of the amendments being made to the Life Act. The proposed new and amended prudential standards do not introduce any new requirements for, or impose additional costs on, life insurers and friendly societies. Nevertheless, they will give APRA flexibility to adapt the prudential framework to future industry developments. Subject to passage of the legislation, the new prudential standards are expected to be available in the fourth quarter of 2007 and take effect on 1 January 2008.

Financial Sector Assessment Program

In October 2006, the IMF released its Financial Sector Stability Assessment report on the strength of Australia's financial system and its regulatory infrastructure. The report was the culmination of a detailed review in 2005/06 by independent experts under the IMF's Financial Sector Assessment Program (FSAP).

As part of this review, APRA's supervision of the banking and insurance industries was evaluated against the Basel Committee's *Core Principles for Effective Banking Supervision* (for banks) and the International Association of Insurance Supervisors (IAIS) *Insurance Core Principles* (for life and general insurance companies). The IMF also conducted a macroeconomic stress test of the capacity of the Australian financial system to deal with certain shocks.

The IMF report provided a strong endorsement of Australia's regulatory framework and of the effectiveness of APRA's prudential supervision. The main findings relevant to the prudential framework were:

- in a number of areas, including transparency, Australia is at the forefront of best practices;
- Australia has a very high level of compliance with the two sets of Core Principles;
- the prudential framework is principles-based and implementation is of a generally high standard;
- most prudential regulations and their implementation are of a very high standard;
- APRA's supervisory activities embody many best international practices and the overall quality of supervision is good; and
- the approach to consolidated supervision is particularly noteworthy.

The IMF report recommended some areas for improving compliance with the two sets of Core Principles and APRA is responding to these, in conjunction with the Government.

APRA-regulated institutions

	Number			Assets ($ billion)[1]		
	30 Jun 06	30 Jun 07	% change	30 Jun 06	30 Jun 07	% change
ADIs[2]	223	220	-1.3	1,643.9	1,946.0	18.4
Banks	54	55	1.9	1,581.1	1,877.4	18.7
Building societies	14	14	0.0	17.9	20.6	14.8
Credit unions	148	143	-3.4	35.7	38.7	8.5
Other ADIs, including SCCIs	7	8	14.3	9.2	9.3	1.1
Representative offices of foreign banks	13	19	46.2			
General insurers	133	131	-1.5	83.0	90.4	8.9
Life insurers	35	34	2.9	226.8[3]	251.3[3]	10.8
Friendly societies	27	25	-7.4	6.6	6.9	4.5
Licensed trustees	307	306	-0.3			
Approved trustees[4]	22					
Superannuation entities	7,812[5]	6,823[5]	-12.7	570.0	712.9	25.1
Public offer funds[6]	248	223	-10.1	428.5	545.0	27.2
Non-public offer funds[6]	576	309	-46.4	132.4	158.1	19.4
Small APRA funds	6,665	6,017	-9.7	3.2	3.3	3.1
Approved deposit funds	182	156	-14.3	0.4	0.5	25.0
Eligible rollover funds	18	17	-5.6	5.5	6.0	9.1
Pooled superannuation trusts[7]	123	101	-17.9	58.9	81.1	37.7
Non-operating holding companies	12	14	16.7			
Total	**8,584**	**7,572**	**-11.8**	**2,530.3**	**3,007.5**	**18.9**

1 Asset figures for end-June 2007 are based on most recent returns. Asset figures for end-June 2006 have been revised slightly from APRA's *2006 Annual Report* in line with the audited returns received during the year.

2 The ADI classification does not include representative offices of foreign banks. SCCIs refer to Specialist Credit Card Institutions.

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

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

5 Includes RSEs that are either registered or unregistered; unregistered RSEs are in the process of winding up, transferring ownership to an RSE licensee or transferring to the Australian Taxation Office (ATO). Does not include uncontactable funds that are in the process of being formally wound-up or transferred to the ATO. At end-June 2007, there were 113 such funds, down from 127 funds at end-June 2006.

6 During 2005/06, some superannuation funds switched between categories.

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

4

APRA’s supervisory capablilites

APRA's move to a more principles-based approach to the prudential supervision framework is complemented by its risk-based approach to the supervision of individual financial institutions. Put simply, risk-based supervision is the process by which supervision activity (e.g. on-site reviews, data analysis, meetings with boards and management) is directed at risk issues of highest priority. It contrasts with mechanical supervisory cycles that apply the same level and intensity of supervision to all institutions, regardless of their risk profiles.

APRA has taken a risk-based approach to supervision for some years. The effectiveness of the approach is based on:

- robust supervisory tools for identifying and assessing emerging risks in a regulated institution;
- a supervisory cadre with appropriate skills, experience and judgment; and
- strong statistical and research capabilities.

Supervisory tools

The centrepiece of APRA's risk-based supervision is a robust system introduced in 2002 to ensure that its supervisors assess risks rigorously and consistently and that supervisory interventions are targeted and timely. The Probability and Impact Rating System (PAIRS) is a risk assessment model and the Supervisory Oversight and Response System (SOARS) guides supervisors in responding to identified risks. The IMF's Financial System Stability Assessment (see previous Chapter) noted that the PAIRS/SOARS systems were "...at the leading edge of current approaches to risk-focussed supervision".

The PAIRS system involves a joint assessment of the likelihood that an institution will fail to honour its financial promises (probability rating) and the impact that the failure of the institution would have on the financial system (impact rating). The probability rating is based on an assessment of the unique risk profile of each rated institution and covers the inherent risks facing the institution, the effectiveness of management and controls in mitigating these risks, and the extent of capital support to meet unexpected losses. PAIRS probability ratings are updated regularly as new information on an institution becomes available and supervisory reviews are completed. The impact rating for an institution is based on its total resident Australian assets.

SOARS supervisory stance

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

Under the SOARS system, the probability and impact ratings for an institution help APRA to determine its supervisory response. There are four supervisory stances involving increasing intensity in APRA's involvement, from routine supervision for Normal institutions through to vigorous supervisory intervention for institutions in Restructure. The SOARS grid has been set so that the larger the regulated institution, the earlier and more proactively APRA responds to a given risk of failure.

At end June 2007, around 66 per cent of risk-rated institutions were in the Normal stance, 32 per cent in Oversight, one per cent in Mandated Improvement and one per cent in Restructure.

In APRA's view, a risk-based approach to supervision has considerably improved the efficiency and effectiveness of APRA's supervisory activities and helped to reinforce standards of risk management in regulated institutions. Nonetheless, in sustained economic good times, the discriminatory power of a risk assessment model may not be easy to assess. As one performance measure, APRA has developed 'transition matrices' to track the migration of institutions between the different supervisory stances. Over the past four years, the great majority of institutions in Mandated Improvement or Restructure at some point in this period have either improved or exited the industry, with only one small failure as such (in superannuation). Of the 176 institutions that have been in these two stances, 35 have improved, 24 remain in their SOARS category, one has been downgraded and 95 have exited.

Though there is no 'counter-factual' to compare these outcomes with what would have happened without APRA's involvement, the direction of movement of institutions in these two supervisory stances is consistent with timely and effective intervention on APRA's part and – for those institutions exiting the market – a receptive market for financial assets and businesses.

Entities in Mandated Improvement (2003/07)

Current stance	Total
Normal	14
Oversight	37
Mandated Improvement	16
Restructure	1
Exit	68
Failure	1
Total	**137**

Entities in Restructure (2003/07)

Current stance	Total
Normal	3
Oversight	1
Mandated Improvement	0
Restructure	8
Exit	27
Failure	0
Total	**39**

The PAIRS and SOARS supervisory tools are supported by an APRA-wide supervisory approach, the APRA Supervision Framework, that assists supervisors in both of its frontline divisions to undertake structured, consistent and well-documented supervisory reviews, irrespective of the size, nature and complexity of the institution.

The Framework comprises a series of modules for supervisory assessment and for minimum supervisory cycles. The on-site components dealing with major risks facing regulated institutions were implemented in 2004/05 and the off-site components have been progressively rolled out since that time.

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

During the year, considerable effort went into improving the integration of the Framework with the PAIRS and SOARS supervisory tools and APRA's supervisory tracking and scheduling tool. A more integrated set of supervisory tools will be rolled out to frontline supervisors by the end of 2007, and will deliver tangible improvements in APRA's efficiency and effectiveness. The efforts will not end there. More complete integration of supervisory tools and systems remains a major objective of APRA's 2006/09 Strategic Plan, discussed in Chapter 6. With this objective in mind, the internal governance of APRA's supervisory infrastructure was broadened and enhanced so as to avoid duplication and inconsistencies in its future development.

APRA's staffing

A risk-based supervisory approach built on supervisory judgment places particular demands on the skills and experience of supervisory staff. Supervisors need to be able to judge whether a specific solution proposed by an institution is adequate to meet the relevant prudential principle; they also need to be astute and confident in identifying emerging risks and pursuing appropriate remedial action. Growing and maintaining a cadre of supervisory staff with these qualities has been a major priority for APRA.

Over recent years, an active recruitment program in Australia has enabled APRA to approach or reach its staffing targets by bringing senior staff from industry and the professions into its ranks. During 2006/07, the program was extended to overseas markets and a number of skilled staff have joined APRA from the United Kingdom, South Africa and South-East Asia. APRA is also committed to the continued recruitment of high quality graduates. By year end, APRA's staff numbers were 582, a slight reduction over the year.

The blending of industry experience and supervisory skills inherited from predecessor agencies has given APRA a strong and stable senior management cadre. However, APRA continues to face challenges in retaining junior- to middle-level staff. These staff, well-trained by APRA and usually with three to five years' experience over a range of risk management areas, are in strong demand from industry; around 90 per cent of staff who leave APRA take up work in the finance sector or in its service providers. In the 2007/08 Commonwealth Budget, the Government approved a New Policy Proposal to assist APRA in recruiting and retaining qualified staff in the current very competitive job market.

APRA's additional funding will be devoted, in part, to enhancing its staff training and development programs. APRA already invests heavily in these programs. Its training expenditure is in the 90th percentile of organisations when benchmarked across all industries, but the skills needed in a complex and dynamic financial system are ever-increasing. Enhanced training and development is one of a number of staffing initiatives under way to improve staff retention. Other initiatives address career progression and mobility, recognition and rewarding of performance, management and leadership, and culture and communication. APRA is a recognised leader in workplace flexibility, understanding that it is a key to attracting and retaining valued staff.

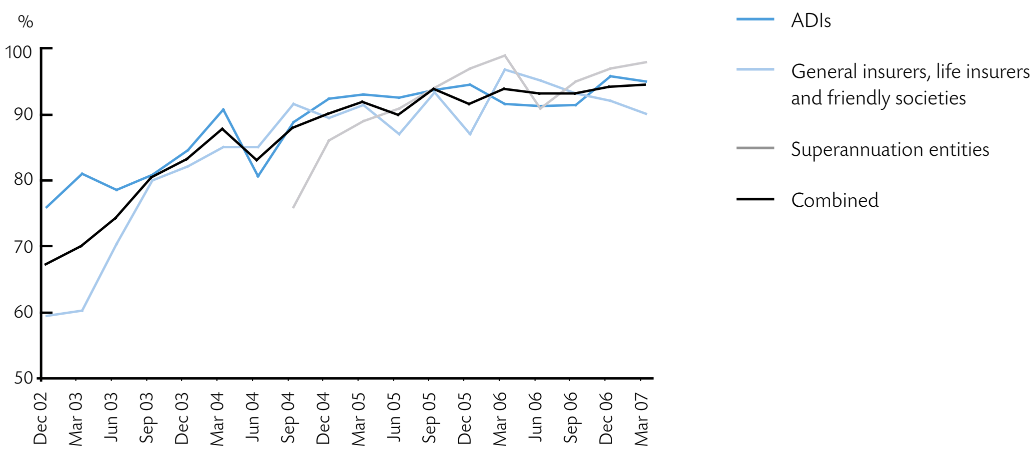
APRA's statistical capabilities

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

APRA also collects data on behalf of the Reserve Bank of Australia and the Australian Bureau of Statistics. About 80 per cent of data collected are shared with other agencies. APRA's published statistics inform many decision-makers in the Australian financial system, including policy-makers, other regulators, market analysts, researchers and senior management of financial institutions, and ultimately contribute to a more stable, competitive and efficient financial system.

APRA has been pursuing a continuous improvement program for the data it collects and the statistics it provides. As a consequence, the timeliness and accuracy of data collected across all industries have improved considerably over the past five years. For regulated institutions, APRA targets a rate of 95 per cent for submission of returns by the statutory due dates, with the remainder usually submitted within the following week. Over 99 per cent of APRA returns are now submitted on time or within one week of the due date.

Returns submitted by the due date



APRA produces a suite of 12 statistical publications which provide regular updates on the financial performance of APRA-regulated industries. APRA follows international standards aimed at ensuring that users can have confidence in the integrity of the data and that statistics are made available on an impartial basis. Improvements in the timeliness and accuracy of data have enabled APRA to bring forward the publication dates for most of its quarterly industry publications.

A major priority for APRA's statistics unit over 2006/07 was the preparation and implementation of changes to prudential reporting requirements. Reporting for general insurers was aligned with APRA's prudential approach to the adoption of International Financial Reporting Standards (IFRS) and new reporting requirements for ADIs were developed as part of the implementation of the Basel II Framework. Significant resources were devoted to reviewing APRA's collection of data from life insurers and friendly societies, to ensure that the collection is effective, relevant and cost-efficient. The project has involved:

- reviewing the structure and content of the data against the requirements of APRA, other government stakeholders and industry;
- upgrading APRA's IT systems (inherited from predecessor agencies) to its standard Direct to APRA (D2A) data collection platform;
- establishing new reporting standards under the *Financial Sector (Collection of Data) Act 2001*; and
- reviewing publications sourced from the data.

After informal discussions with industry, APRA issued a formal consultation paper in April 2007 and it has been considering submissions. New reporting standards are expected to be finalised by the end of 2007.

APRA has been actively involved, along with other agencies, in the development of the Government's Standard Business Reporting (SBR) program, announced in August 2007. This whole-of-government initiative, a recommendation of the Taskforce on Reducing Regulatory Burdens on Business, is aimed at reducing reporting burdens by streamlining and automating reporting between businesses and government agencies and eliminating duplication. The Chairman of APRA is on the SBR Board and the General Manager-Statistics is on the SBR Steering Group. Separately to this initiative, APRA and ASIC are reviewing their administrative practices to remove any sources of reporting overlap, inconsistency or duplication.

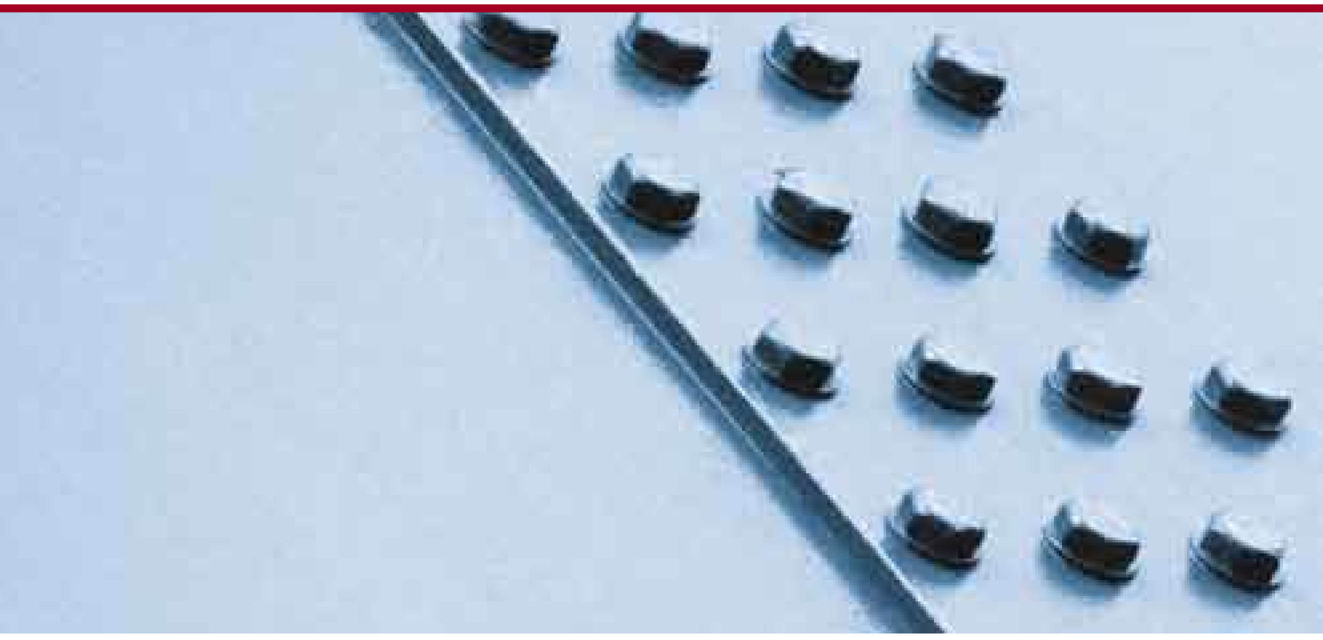
APRA's statistics unit fulfilled around 500 requests for customised statistics over the past year. These statistics give more detailed insight into particular aspects of the financial system than APRA's regular publications. The statistics are provided to APRA staff and to external users such as other government agencies, financial institutions, market analysts, researchers and universities. Customised statistics are also provided to international agencies such as the Organisation for Economic Co-operation and Development (OECD), IMF and Bank for International Settlements, to facilitate comparisons of various aspects of the Australian financial system with those of other countries.

APRA's research capabilities

APRA's applied research unit identifies issues that are likely to be of prudential significance over the medium- to long-term. This work informs policy direction and supervisory strategies. Over the past year, the unit investigated catastrophe modelling in the general insurance industry; statistical techniques to predict the risk ratings of regulated institutions; credit standards for ADIs, particularly debt serviceability; and performance and governance issues in superannuation.

The unit published three papers in international journals to share knowledge and quantitative insights with the broader research community. Three more papers were accepted for publication and are under editorial review. Two papers in the APRA working paper series were published on the APRA website.

APRA continues to support university research relevant to prudential regulation on a modest basis. Research topics in 2006/07 included modelling Value at Risk (VaR) and stressing credit risk parameters. APRA will offer four PhD internships from July 2007 under a program it has developed with a major university.



5

Co-operation and liaison

In a rapidly changing financial environment, APRA's links with domestic and international regulatory agencies, and with industry and other groups, are essential in ensuring that the prudential framework and APRA's supervisory approach are aligned with market realities and best practices, and are alert to emerging risks. Australia's prudential framework has high standing globally and APRA's international liaison activities, in turn, give Australia a strong voice in global reform initiatives in this area. These activities also provide important input into APRA's risk assessment of internationally active financial institutions.

Australia

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

Co-operation among these three agencies, and with the Australian Treasury, takes place at the highest level through the Council of Financial Regulators. The Council operates as a forum for discussing regulatory issues and sharing information and views. Its main focus is to ensure that there are appropriate arrangements among the members for co-ordinating their activities in response to potential or actual pressures, and to advise the Government on the adequacy of Australia's financial system regulatory architecture. During the past year, the Council's main priority was its review of crisis management arrangements in the Australian financial system. After further consultations with industry, the Council endorsed the introduction of schemes to provide depositors in a failed ADI and policyholders in a failed insurer with timely access to at least some of their funds. As part of the Government's consideration of the Council's proposal, a further round of industry consultations was held on specific design features of the schemes and on the potential costs of implementation. The Government is now considering the proposal. As discussed in Chapter 2, the Council also examined various aspects of private equity in Australia and released a report on this subject in March 2007. Other matters considered by the Council in 2006/07 included global credit and equity market developments, pandemic planning, the failure of a number of property investment companies, trans-Tasman banking regulation and the recommendations of the Taskforce on Reducing Regulatory Burdens on Business.

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

APRA also meets regularly with the individual Council members under the terms of relevant Memoranda of Understanding (MoU). Over the year, meetings of the RBA/APRA Co-ordination Committee paid particular attention to emerging risk issues in housing lending and global financial market developments. Other matters included statistical issues relating to new and amended collections, definitions and the service level agreement between the two agencies; contingency planning and stress testing, including for pandemics; operational matters such as information-sharing on critical incidents in the payments system; and progress in the implementation of the Basel II Framework.

Over the year, meetings between APRA and ASIC, on a number of levels, covered a range of operational and enforcement matters. As well as dealing with specific institutions, the two agencies discussed current and emerging issues affecting industries regulated by both agencies. These included the impact of the Government's 'Better Super' initiatives and proposed amendments to the *Insurance Act 1973* dealing with direct offshore foreign insurers (DOFIs) and discretionary mutual funds (DMFs). APRA and ASIC also collaborate through a working group responding to recommendations made by the Taskforce on Reducing Regulatory Burdens on Business. The working group is focussing on financial and regulatory reporting, data collection, licensing and breach reporting, and published a status report in February 2007.

In response to the Government's *Statement of Expectations* of APRA, which encouraged APRA and ASIC to explore mechanisms for joint consultations with industry, regular meetings have been established between APRA Members, ASIC Commissioners and the Finance Industry Council of Australia (FICA), an umbrella body for a number of finance industry associations. The meetings are intended to cover emerging supervisory and industry issues of relevance to the two agencies, the development of financial services regulation and regulatory co-ordination in practice. The first meeting, in which Abacus—Australian Mutuals (the Association of Building Societies and Credit Unions) and the Association of Superannuation Funds of Australia also participated, was held in July 2007.

APRA and the Treasury worked closely during the year on a number of legislative initiatives, particularly those arising from the Government's Simplifying Regulation proposals in response to the Taskforce on Reducing Regulatory Burdens on Business (see page 29). Other significant areas of co-ordination were trans-Tasman banking legislation, the Government's 'Better Super' initiatives, DOFIs and DMFs and legislation to facilitate the establishment of non-operating holding company (NOHC) structures by APRA-regulated institutions.

In February 2007, APRA signed an MoU with the Australian Transaction Reports and Analysis Centre (AUSTRAC) to facilitate co-operation and the exchange of information. Development of the MoU followed the introduction of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*, which removed legal barriers to the sharing of information between the two agencies. The MoU recognises the importance of co-operation between APRA and AUSTRAC to promote confidence in the integrity of the Australian financial system. Under the MoU, the two agencies have agreed to assist each other in relation to the exchange of information, appropriate referral of matters and co-operation in regulation, compliance and enforcement, consistent with relevant legislation. A joint AUSTRAC/APRA Co-ordination Committee, co-chaired by senior executives from each agency, has been established to develop and maintain close working relationships. Committee meetings to date have focussed on promoting understanding of each agency's activities (particularly where they impact on jointly regulated institutions) and the development of information-sharing protocols. Opportunities to exchange staff are also being explored.

During the year, APRA and the Australian Taxation Office (ATO) revised their MoU on superannuation to reflect their current activities and arrangements for the exchange of statistical and other information. APRA and ATO staff meet on a quarterly basis; they liaised extensively in the lead-up to the Government's 'Better Super' initiatives from 1 July 2007, particularly in relation to the extended use of Tax File Numbers (TFNs) for superannuation purposes and the ATO's responsibilities for self-managed superannuation funds. APRA continues to participate in the ATO's Superannuation Consultative Committee, whose other members comprise Treasury, ASIC and representatives from major industry organisations.

APRA also meets regularly with other official and industry organisations. It has a close working relationship with the Private Health Insurance Administration Council (PHIAC), which has responsibility for supervising providers of health insurance. Over the year, APRA provided support to PHIAC in applying a risk-based supervision methodology to health insurance and by making specialist insurance supervisors available to assist in the review of PHIAC-regulated institutions. APRA works closely, as well, with State regulatory bodies for compulsory third-party motor vehicle insurance (the Motor Accidents Authority of New South Wales and the Motor Accident Insurance Commission of Queensland). APRA also liaises with the Financial Reporting Council and the two Boards it oversees: the Australian Accounting Standards Board (AASB) and the Australian Auditing and Assurance Standards Board (AuASB). During the year, APRA contributed to the discussions of the Financial Reporting Council on sector-neutral standard setting in Australia and auditor independence, to the AASB's work on reporting by superannuation funds and to the AuASB's guidance for auditors of general insurers and other regulated institutions.

APRA is a permanent member of the Banking and Finance Infrastructure Assurance Advisory Group (BFAG) and currently provides the Deputy Chair. BFAG was established under the Government's Trusted Information Sharing Network, an umbrella public-private partnership framework for sharing information on security issues that affect critical infrastructure. BFAG's mission includes strengthening the ability of the financial system to continue its vital role in the event of industry-wide operational disruption. BFAG includes representatives from many major financial institutions, financial markets, industry associations and State and Australian Government agencies. During the year, BFAG completed a sector resilience assessment which showed participating institutions have a level of maturity in crisis management, business continuity and disaster recovery plans. A cyber security working group was established as a forum for raising cyber and IT security issues, and a banking and finance sector crisis communication plan was developed, for testing later in 2007.

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

APRA recognises the key role played by the actuarial profession in promoting sound financial management and prudent risk management in the general insurance, life insurance and superannuation industries, not only through the statutory roles of Appointed or Approved Actuary but also through advice on financial and risk management issues to boards and management of institutions for which they have responsibility. APRA meets regularly with representatives of the relevant practice committees of the Institute of Actuaries of Australia to discuss issues of mutual interest, such as the profession's views on APRA's prudential policy initiatives, or to ensure that the Institute's professional standards and practices appropriately complement APRA's prudential requirements. Many APRA staff who are members of the Institute participate actively in task forces and committees of the Institute, which also contributes to a shared perspective on issues of mutual interest.

International liaison

The ability to exchange confidential information with overseas prudential regulators is critical to the supervision of APRA-regulated institutions that also operate in other jurisdictions and of foreign financial institutions for which APRA is 'host' supervisor. To this end, APRA has been strengthening arrangements for sharing information.

Since 1 July 2006, it has signed MoUs with US banking authorities (the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation), the Insurance Authority of the Hong Kong Special Administrative Region, the Office of the Superintendent of Financial Institutions of Canada, the Autorité de Contrôle des Assurance et des Mutuelles of France and the Bank Supervision Department of the Reserve Bank of South Africa. Arrangements for information-sharing were also put in place with the Financial Supervisory Commission of Taiwan and the State Bank of Vietnam. APRA now has information-sharing arrangements in place with 16 overseas regulators (which can be viewed on the APRA website) and several other MoUs are under discussion. APRA has also been involved in work by the International Association of Insurance Supervisors to agree a multilateral MoU template and vetting mechanism. APRA will be working towards becoming a signatory to the multilateral MoU.

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

- **International Association of Insurance Supervisors (IAIS).** This group issues global insurance principles, standards and guidance papers, provides training and support on issues related to insurance supervision and organises meetings and seminars for insurance supervisors. The IAIS also works closely with other financial sector standard-setting bodies and international organisations to promote financial stability. APRA is a member of the IAIS Executive Committee and its Technical Committee which has responsibility for the development, through a range of subcommittees, of IAIS principles, standards and guidance papers, and APRA representatives are active in the Accounting, Insurance Contracts, and Solvency subcommittees. Major priorities for the IAIS over 2006/07, and on which APRA has focussed most of its contribution, have been finalising a risk-based solvency framework for insurers and working with the International Accounting Standards Board (IASB) on insurance liability valuation and reporting. Out of this work, guidance papers are being prepared on asset and liability valuation, capital requirements and capital management, risk management and the use of internal models, with a view to developing principles-based standards in 2008 and 2009. The IAIS has also made further progress in the areas of disclosure, fit and proper requirements, fair value measurements, asset/liability management, finite reinsurance and risk transfer, supervision of financial conglomerates and insurance fraud.
- **Basel Committee on Banking Supervision.** Australia is not a member of this Committee but APRA is represented on a number of its working groups and subcommittees. APRA places particular importance on the International Liaison Group (ILG), which is the major vehicle for consultation between the Basel Committee and non-member countries. APRA also participates in various subgroups involved in the implementation of the Basel II Framework, including the ILG's Working Group on Capital and the Validation and Operational Risk subgroups of the Accord Implementation Group (AIG), which are examining issues relating to the validation of banks' credit and operational risk estimates that will be used as inputs under the Framework.

  APRA participates as an observer on the Basel Committee's Accounting Task Force (ATF) and contributes to its activities, including hosting one of its meetings in Sydney during 2007. The ATF is assessing the impact of key international financial reporting standards on prudential regulation, particularly fair value measurement. APRA has also joined two new Basel Committee subgroups, dealing with liquidity and the definition of capital.

  A senior officer of APRA is on secondment to the Basel Committee Secretariat.
- **Joint Forum**. APRA and ASIC represent Australia on the Joint Forum, a body working under the umbrella of the Basel Committee on Banking Supervision, the IAIS and the International Organization of Securities Commissions (IOSCO).

The work of the Joint Forum encompasses issues relating to financial conglomerates and other issues that are common across banking, insurance and securities sectors. Current activities include a cross-sector review of internal practices to manage customer suitability obligations in the sale of retail financial services and products, a cross-sector review of the identification and management of risk concentrations across financial conglomerate groups, and a review of the implementation of the 1999 Joint Forum principles of conglomerate supervision. Recent publications by the Joint Forum deal with regulatory and market differences across sectors, the management of liquidity risk across financial groups and high-level principles for business continuity.

- **International Organisation of Pension Supervisors (IOPS).** This body, representing supervisors of private pension systems, was formed in 2004 to become the global standards-setter for the pensions industry, to promote international co-operation on pension supervisory issues and to provide a global forum for policy dialogue and exchange of information on these matters. APRA is on the foundation board of IOPS and is a member of the Technical Committee. During the year, APRA continued work on the joint OECD/IOPS project on licensing guidelines and provided input to work relating to risk-based supervision and to on-site and off-site supervisory activities.
- **International Actuarial Association (IAA).** The IAA is dedicated to research, education and development of the actuarial profession and national actuarial associations. It oversees development of guidance notes relating to areas of international actuarial practice, such as for IFRS, and is currently responding to requests from the IAIS for advice on internal models and on measurement of liabilities for insurance contracts. Senior APRA staff have representative roles on a number of IAA committees on behalf of the Institute of Actuaries of Australia (IAAust) and the IAIS. One APRA staff member is chair of the Professionalism Committee and is involved in the development of an international actuarial education program aimed at strengthening actuarial capabilities in developing countries.

APRA also meets annually with integrated supervisory agencies from a number of countries to discuss issues arising out of the integrated supervisory model. At the ninth such conference, in June 2007, the subjects considered included organisational structures for integrated supervision, staff training and new global capital adequacy regimes for banking (the Basel II Framework) and insurance (Solvency II in Europe).

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

Technical assistance

The Australian Government has been increasing its assistance activities in the Asia-Pacific region over recent years, particularly in Indonesia and the Pacific island nations. APRA has played a modest but continuing role in this as part of a whole-of-government approach, through closer engagement with its regulatory counterparts in the region. The importance of APRA's role in providing technical and other assistance is acknowledged in the Government's *Statement of Expectations* of APRA. APRA's costs for this work are funded primarily through AusAid.

In the Pacific, the emphasis is on multilateral engagement to promote regional solutions and harmonisation of approaches. There are two mutually reinforcing programs: an intern program where supervisors from Pacific countries spend periods from one to four months at APRA enhancing their practical supervision skills (including through on-site visits) and an on-site supervision program *in situ* where an APRA advisor assists teams of regional supervisors during on-site visits to supervised institutions. During 2006/07, APRA hosted seven interns from Pacific countries – five from Papua New Guinea and one each from Fiji and the Cook Islands. Three on-site visits were conducted to Papua New

Guinea, two for superannuation funds/administrators and one for savings and loan societies; supervisors from Fiji, Samoa, Solomon Islands and Vanuatu were involved.

In Asia, there has been a particular focus on Indonesia. APRA has been developing a good working relationship with BAPEPAM-LK, the integrated regulator of securities markets and non-bank financial institutions. APRA provides technical and strategic advice on risk-based supervision and related matters, through visits of senior APRA staff to Indonesia and visits to Australia by senior officials and BAPEPAM-LK interns. Under an ongoing program, there were seven interns during the year, for periods of three months; interns return to participate in development and adaptation of supervisory systems and procedures to Indonesian conditions. APRA is also strengthening its contacts with Bank Indonesia, the banking supervisor, and provided a three-month internship at APRA during the year.

The Association of Financial Supervisors of Pacific Countries facilitates co-operation between regulators in the region. APRA represents Australia as an observer at Association meetings and supports its training activities, through sponsored speakers and administrative support for training initiatives when conducted in Australia.

APRA is also a member of:

- the South-East Asia New Zealand and Australia (SEANZA) Forum of Banking Supervisors;
- the Financial Regulators Training Initiative (FRTI) Banking Supervisors' Advisory Group of Asia-Pacific Economic Co-operation (APEC); and
- the Australian APEC Study Centre Advisory Group. In July 2006, APRA provided financial sponsorship as well as administrative and logistical support to an FRTI Conference in Perth.

APRA also participates in the South-East Asian Central Banks (SEACEN) Conference of Directors of Supervision.

APRA continues to support the deepening of capacity and the international broadening of knowledge on prudential supervision by providing expert speakers to various institutes, including the Financial Stability Institute (of the Bank for International Settlements), the APEC Study Centre at Monash University and the SEACEN Institute. During 2006/07, APRA provided 11 speakers to conferences organised by the Financial Stability Institute, which are often co-hosted with other regional bodies.

During the year, APRA hosted over 100 international delegations, around the same number as the previous year. Visits were mainly from regulatory agencies, international organisations, government and government agencies and research bodies, and private sector organisations. Apart from APRA's functions, operations and prudential policies and practices, the main topics of interest were superannuation and insurance industry developments and supervision, Basel II implementation and enquiries about setting up operations in Australia. Around 60 per cent of visits were from developing countries (especially China, Indonesia and Papua New Guinea), around 30 per cent from developed countries and the balance from multilateral institutions.

6
APRA's costs and performance

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

Financial performance

APRA's expenditure

APRA's total operating expenditure in 2006/07 was $91.1 million. This included costs of $0.6 million in relation to the HIH Royal Commission, for which separate appropriations were received in 2001/02[1], 2004/05 and 2006/07, and costs of $1.2 million which are covered by additional revenue sources. Excluding these amounts, operating expenditure was $89.3 million, compared with the budget of $92.1 million.

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

Operating expenditure and staff trends

	$ million	Average staffing level[2]
2002/03	62.7	457
2003/04	71.5	496
2004/05	78.2	532
2005/06	88.1	592
2006/07	89.3	551
2007/08 (budgeted)	97.1	582

The increase in APRA's running costs over this period 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. APRA reached its staffing targets in 2005/06 but average headcount declined in 2006/07 because of the departure of staff on fixed-term contracts after the superannuation licensing program ended and a spike in voluntary turnover in the first part of the year in a highly competitive labour market.

[1] APRA received an appropriation of $4 million in 2001/02 specifically for the costs of the HIH Royal Commission. In addition, $2 million was appropriated in 2004/05 for further work on following up the recommendations of the Royal Commission. A further $3.7 million was appropriated in 2006/07 to complete this work.

[2] Staffing figures are full-time equivalent headcount averaged 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 2006/07 is $2.5 million of the separate appropriation from the Government in relation to the HIH Royal Commission; the unspent balance has been carried forward to 2007/08.

Levies are raised according to the *Financial Institutions Supervisory Levies Collection Act 1998* and six other Acts applying to the main industry sectors. Prior to the beginning of each financial year, the Minister announces the levy determinations for each industry sector with a rate to be applied on assets, subject to a minimum and maximum amount per institution, except for non-operating holding companies that are levied at a flat rate. The levies collected by APRA also cover some costs of ASIC and the ATO. The process includes detailed consultation with the main industry groups and the Treasury. Levies are based on industry sectors. The total levies collected by APRA for all three agencies in 2006/07 were $112.3 million, compared with the plan of $103.8 million.

APRA's total revenue from ordinary activities in 2006/07 was $108.1 million. After adjusting for HIH Royal Commission funding and additional revenue from the direct cost recoveries, net revenue was $104.2 million, compared with the original budget of $92.2 million. APRA is returning $14.7 million to industry sectors in 2007/08 by way of reduced levies, comprising $8.5 million in previous over-collections of levies and $6.2 million of excess reserves.

Reserves

APRA had an operating surplus from ordinary activities of $17.1 million in 2006/07. This has increased total reserves, including accumulated surpluses, to $29.6 million. As noted above, APRA is reducing reserves by $14.7 million in 2007/08. It has also quarantined $6 million of reserves in a Contingency Enforcement Fund to be used for large unexpected investigation and enforcement activities.

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 and promotes financial system stability in Australia. In 2005/06, APRA formalised its business planning process and introduced a three-year Strategic Plan designed to deliver this outcome in an efficient and effective way.

The Strategic Plan sets out APRA's strategic direction over the three financial years 2006/07 to 2008/09. The Plan was reviewed after its first year in the light of the Government's *Statement of Expectations* of APRA and developments in APRA's external operating environment.

The Plan identifies seven strategic objectives and the initiatives APRA will undertake to meet them. The objectives are to:

- conduct effective, ongoing supervision of all APRA-regulated entities in accordance with the APRA Supervision Framework;
- consolidate the prudential framework by completing APRA's major prudential reform agenda, promoting harmonised prudential standards across industries and examining ways of removing unnecessary regulatory burden;

- enhance the efficiency and effectiveness of APRA's supervisory tools and systems through better integration of tools, greater analytical support for PAIRS assessments, and workflow and document management;
- enhance APRA's effectiveness by continuing to ensure it recruits and retains the right people for the job, develops the skills and knowledge of its staff and deploys them where they are most needed in APRA;
- improve communications, both internally and externally, to ensure that APRA staff have the most up-to-date information about issues facing APRA and that Government, industry and the financial community are aware of and confident in the role and activities of APRA;
- remain well prepared for a crisis affecting APRA's own operations, a financial crisis in a regulated institution and a systemic crisis such as a pandemic or terrorism; and
- review management practices to ensure that APRA has robust risk management, internal systems and control processes.

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

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

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

As noted in Chapter 1, the *Statement of Expectations* has confirmed that prudential regulation should not pursue a 'zero failure' objective. Rather, the objective is to maintain a low incidence of failure of supervised institutions while not impeding continued improvements in efficiency or hindering competition. APRA fully supports this objective. APRA's aim is to identify likely failures early enough so that corrective action can be initiated to prevent the failure, or at the least to set in train appropriate wind-up or other exit strategies to minimise losses to beneficiaries. Since APRA's inception in 1998, the annual PER has averaged 99.93 per cent and the annual MPR, which is dominated by the losses associated with HIH, has averaged 99.94 per cent.

The *Statement of Expectations* encourages APRA to implement the recommendations of the Taskforce on Reducing Regulatory Burdens on Business that APRA develop a broader suite of performance indicators, in addition to the two safety measures above, consistent with its statutory responsibilities. APRA has been developing other indicators that might be useful as a guide to its supervisory performance and will continue this work.

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	5	12	4,473	877,172	99.89	99.99
2000	3	308	4,407	993,369	99.93	99.97
2001	5	5,341[4]	4,350	1,043,111	99.89	99.49
2002	2	140	3,803	1,009,373	99.95	99.97
2003	5	20	3,252	1,068,081	99.85	99.99
2004	1	0[5]	2,745	1,207,119	99.96	100.00
2005	0	0	2,099	1,346,253	100.00	100.00
2006	0	0	1,596	1,548,454	100.00	100.00
2007	1	0[5]	1,244	1,837,363	99.92	100.00

1. Failures have been redefined to include failures due to employer sponsors in superannuation funds. Prior year measurements, which had excluded such failures, have been changed accordingly. Failures exclude unresolved cases; if these 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 $3,007 billion at end-June 2007.
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.
5. Losses incurred, due to the failure of an employer sponsor in a superannuation fund, were less than $0.5 million.

7 Governance

Governance structure

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

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

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

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

Members' attendance at Executive Group meetings from 1 July 2006 to 30 June 2007

	Meetings	Attended
John Laker	14	14
Ross Jones	14	14
John Trowbridge	14	14

Details on APRA Members are provided on pages 58-59.

Risk Management and Audit Committee

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

The Committee comprises an external chair (with casting vote), one external member, one member of APRA's Executive Group and one Executive General Manager (on 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 2006/07, the Committee conducted a review of its activities and charter to ensure that it would be compliant with the requirements of the *Financial Management and Accountability Act 1997* from 1 July 2007.

The members of the Committee in 2006/07 were:

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

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

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

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

Rogers holds a number of directorships, including Chairman of Golden Casket Lottery Corporation Limited, UniQuest Pty Limited and Business Management Limited and is a director of Magellan Petroleum Australia Ltd. He was Chairman of the compliance committee of Suncorp Metway Investment Management Limited for over six years.

Mr John Trowbridge
APRA Member

Mr Tom Karp (from 1 July 2006 to November 2006)
Executive General Manager - Supervisory Support

Mr Wayne Byres (from December 2006 to 30 June 2007)
Executive General Manager - Diversified Institutions

Attendance at Risk Management and Audit Committee meetings from 1 July 2006 to 30 June 2007

	Meetings	Attended
Elizabeth Alexander	4	4
Norbury Rogers	4	4
John Trowbridge	4	4
Tom Karp	1	1
Wayne Byres	3	3

Risk Assessment and Internal Audit

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

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

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

Fraud risk management is an ongoing focus within APRA. APRA has a comprehensive fraud control framework and a review of fraud controls was undertaken as part of the unit's 2006/07 work program. All audits undertaken by the unit assess whether potential fraud exposures are appropriately addressed by APRA's processes and controls. There were no incidents of fraud reported for the year.

Other governance matters

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

APRA Members

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

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

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

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

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

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

Mr John Trowbridge
BSc (Syd), BE (Syd), BA (ANU), FIA, FIAA
Member

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

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

TREASURER

PARLIAMENT HOUSE
CANBERRA ACT 2600

Telephone: (02) 6277 7340
Facsimile: (02) 6273 3420
www.treasurer.gov.au

20 FEB 2007

Dr John Laker
Chairman
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

Dear Dr Laker

I am pleased to provide you with my Statement of Expectations for the Australian Prudential Regulation Authority (APRA). This Statement forms part of the implementation of the Government's response to the *Review of Corporate Governance of Statutory Authorities and Office Holders*, which was conducted by Mr John Uhrig (the Uhrig Report). The Uhrig Report identified ways in which the governance of Commonwealth portfolio bodies may be improved and recommended options for increasing transparency and accountability and ensuring well-defined responsibilities and clear relationships between portfolio bodies and other arms of Government.

This Statement also forms part of the implementation of the Government's response to the Report of the *Taskforce on Reducing Regulatory Burden on Business* (the Banks Report). In particular, Recommendation 5.1 of the Banks Report proposed that the Government provide specific guidance to APRA and ASIC about the appropriate balance between pursuing safety and investor protection, and market efficiency. This Statement of Expectations provides guidance to APRA on this issue, consistent with the legislative framework of APRA. This Statement also encourages APRA to implement some of the more specific recommendations of the Banks Report.

The Government is issuing a Statement of Expectations to portfolio bodies and requesting that portfolio bodies reply with a Statement of Intent. I look forward to receiving APRA's Statement of Intent within three months from the date of this letter. In the interest of public accountability both of these documents will be made public simultaneously. It is my intention that this Statement will be reviewed as circumstances require.

This Statement of Expectations outlines the Government's current objectives in the area of prudential regulation and the Government's expectations for APRA with regards to its conduct, role and responsibilities, relationships with the Government and issues of transparency, accountability and operation. As recognised by the Uhrig Report, I have taken into account the nature of APRA' s independence in making this Statement. It is imperative that APRA continues to act independently and objectively in the exercise of its powers.

At the outset, I would like to make it clear that the Government is very pleased with the overall performance of APRA as a key economic regulator. The Government has provided APRA with significant funding increases in recent years, confirming its capability and capacity to carry out its statutory mandate. However, there is a need to continually reassess performance of regulatory institutions to ensure that they are continuing to meet community expectations and market developments.

The Role and Responsibilities of APRA

The effectiveness of economic regulation is a key contributor to strong economic growth and the wellbeing of the Australian people. The efficient operation of Australia's financial system is supported by a combination of laws, institutions, regulatory policies and administrative practices. The Government is committed to ensuring a regulatory environment that maintains financial stability, fosters competition, promotes innovation and enterprise and provides appropriate safeguards for consumers. The Government's focus has been on reducing unnecessary complexity, minimising compliance costs, enhancing competition and better equipping consumers to benefit from competitive markets.

APRA's Role, Objectives and Priorities

The prime responsibility for ensuring that financial institutions keep the financial promises they make to consumers rests with the board and management of these institutions. Prudential regulation seeks to reinforce the role of the board and management in meeting financial promises by addressing two potential sources of market failure:

- by limiting the systemic risks associated with breaches of financial promises; and
- by reducing the risk of loss by consumers from breaches of financial promises where consumers may have difficulty assessing the creditworthiness of financial institutions making the promises.

It is recognised that prudential regulation cannot and should not seek to guarantee a zero failure rate of prudentially regulated institutions or provide absolute protection for market participants (including consumers). A regulatory approach of this intensity would remove the natural spectrum of risk that is fundamental to well-functioning markets, and ultimately reduce the efficiency and growth of the Australian economy. It is important that the prudential regulation regime maintains a low incidence of failure of regulated entities while not impeding continued improvements in efficiency or hindering competition.

The existence of a prudential regulator and a regulatory regime may lead people to expect a higher degree of protection than is achievable or desirable. The prudential regulator has a role in explaining to the financial sector and the wider public, the rationale for prudential regulation, the role of the prudential regulator, and the outcomes that can be realistically expected from the prudential regulatory framework.

APRA is responsible for regulating bodies in the financial sector in accordance with the laws of the Commonwealth that provide for prudential regulation. These laws are aimed at promoting financial system stability in Australia and protecting the interests of depositors, insurance policyholders and superannuation fund members, while allowing the continued development of viable, competitive and innovative industries in the financial services sector.

APRA is expected to license only those institutions which are able to meet prudential requirements, to promote sound risk management practices in regulated institutions, provide for early detection and resolution of financial difficulties and enforce prudential requirements to reinforce prudent behaviour. This contributes to the financial health of market participants, the integrity of the market, the promotion of financial stability and the protection of the interests of consumers as a whole.

While effective regulation can help support business activities and economic growth, over-regulation or inappropriate regulation can impose unnecessary complexity and compliance costs on regulated financial institutions and on the wider economy. This highlights the inherent need to balance safety and efficiency considerations in all prudential decisions. In performing and exercising its functions and powers, APRA is required by its enabling legislation, the *Australian Prudential Regulation Authority Act 1998* (the APRA Act), to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

The Government expects that APRA will comply with the Government's policy on best practice regulation on all regulatory proposals before they are introduced. Within the context of government policy and legislation, priority should be given to initiatives which minimise procedural requirements and business costs and improve commercial certainty about the practical operation of the regulatory framework administered by APRA.

The Government's preference is for the avoidance of unnecessarily prescriptive regulation and for APRA's prudential regulation to identify the outcomes that are desired from financial institutions rather than prescribe how those outcomes should be achieved. An outcomes-based approach is also more likely to accommodate structural change within the financial sector and not unduly constrain financial institutions from pursuing opportunities for competition and innovative development.

APRA should regularly and proactively review the effectiveness and continuing relevance of the prudential regulation regime in the context of market developments, which will also help identify possible future material risks and regulatory responses.

Collection of Data

APRA is responsible for collecting and analysing data from prudentially regulated and other financial institutions. It is important that APRA maintain its high standard of data collection and analysis, including where APRA shares data with the Reserve Bank of Australia and the Australian Bureau of Statistics, by continuing to:

- collect relevant and necessary data;
- provide electronic means for entities to submit data securely and efficiently;
- ensure entities provide timely and accurate data; and
- publish useful data and statistical analysis of a high standard.

Review of APRA guidance

Recommendation 5.5 of the Banks Report recommended that APRA review its guidance material to ensure it provides effective guidance on good practice in meeting regulatory requirements and does not impose additional or inflexible regulatory requirements. The Government acknowledges that APRA is undertaking work in this area and encourages APRA to implement this recommendation.

Key performance indicators

Recommendation 5.2 of the Banks Report recommended that APRA develop a broader suite of performance indicators, in addition to existing safety measures, consistent with its statutory responsibilities. The Report recommended that any indicators should be reported in APRA's annual report and should be accompanied by guidance in their interpretation, particularly where outcomes may be influenced by factors outside APRA's control. The Report also recommended that the performance indicators and accompanying guidance should be developed in consultation with the Government.

The Government encourages APRA to implement this recommendation, thus ensuring that APRA continues to take a balanced approach to regulation. I have asked Treasury to work with APRA during the implementation stage. As an initial priority, APRA could develop reporting against indicators of timeliness, stakeholder satisfaction and business compliance costs.

Indicators of the broader economic impact of APRA's supervisory conduct may be developed over the longer term.

Relationships between APRA and the Government

The Government recognises and will continue to respect the operational independence of APRA and its responsibility for prudential regulation as provided by statute. It is important for confidence in the regulatory framework that APRA is, and is seen to be, exercising independent judgment about the application of the framework to individual circumstances.

Nevertheless, APRA was established to administer regulatory frameworks which have been designed to implement government policies and priorities relating to business regulation generally and prudential regulation in particular. The Government has a legitimate interest in APRA's operations, its policies and the way they are applied given their potential impact on the economy and individuals' well-being.

Relationship with the Minister

It is important that, in performing its statutory functions and powers, APRA has regard to the Government's broader microeconomic reform objectives. Maintaining a high level of awareness of the Government's policy agenda will place APRA in a position to fully respond to Government policy directions and objectives.

The Government has primary responsibility for setting prudential policy. APRA plays an essential role in ensuring that the Government is well placed to respond promptly to issues that may arise in this area. Under the APRA Act, APRA may provide the Minister with advice on matters concerning improvements to financial safety and efficiency, competition, contestability or competitive neutrality of the financial sector, or changes to prudential framework laws that would overcome or assist in overcoming problems APRA has identified in the course of performing any of its functions. APRA must also provide the Minister with advice if it considers an APRA-regulated body is in financial difficulty.

Another key role of APRA is to provide me, and other Treasury portfolio Ministers as appropriate, with accurate and timely advice on significant issues in its core area of business. Significant issues might include: issues for which the Government is likely to be accountable in Parliament; important APRA operational and budgetary issues; and APRA's decisions regarding the appropriate action for it to take following substantial problems or disruptions in the market, including a substantial breach of the prudential framework.

Under section 12 of the APRA Act, the Minister is able to give APRA a written direction about policies it should pursue or priorities it should follow, but must not give a direction about a particular case. This means that APRA has complete independence in relation to the performance of its functions and exercise of its powers in relation to a specific matter. Given the importance the Government attaches to protecting APRA's independence, both real and perceived, the use of the directions power would only be considered in rare and exceptional circumstances. I note that this power has not been used to date.

Relationship with Treasury

The Government, with advice from Treasury, is responsible for developing legislation to give effect to its policy objectives relating to APRA and prudential regulation. APRA is primarily responsible for the administration of those laws and the conduct of prudential regulation, including developing prudential standards and guidance.

To fulfil these respective roles, Treasury and APRA need to maintain a close working relationship. Treasury takes into account the views and experience of APRA when considering and advising on changes to prudential regulation policy and legislation. By advising Treasury on the operational implications of Government policy initiatives, APRA contributes to policy development. It is also imperative that APRA continues to consult with Treasury, in the development of substantive operational policies, to facilitate consistency between the objectives of legislation and its practical implementation through prudential standards and guidance.

The Memorandum of Understanding between Treasury and APRA clarifies the priorities of each organisation and assists both in carrying out their respective roles effectively.

The Government accepted the Uhrig Report recommendation that portfolio bodies should provide information to portfolio secretaries in parallel to that information being provided to Ministers. This should ensure that Treasury continues to be placed in a good position to fulfil its role as the principal source of advice on prudential policy matters. The Chair of APRA remains responsible for the direct oversight of APRA.

Regulatory Cooperation

Given the growing interdependence of markets, APRA does not operate in isolation. It forms one part of Australia's system of economic regulation. It is important that robust, effective and collaborative working partnerships be maintained between APRA and other Commonwealth and State and Territory agencies, particularly the Australian Securities and Investments Commission (ASIC), the Australian Taxation Office, the Reserve Bank of Australia, AUSTRAC and the Australian Competition and Consumer Commission (ACCC). The structure of Australia's regulatory framework is such that it depends on close cooperation and liaison between the regulators to manage areas where their responsibilities intersect.

By taking a holistic approach to formulating and reviewing its standards and guidance and undertaking its supervision and enforcement activities, APRA should ensure that its prudential requirements and activities intergrate as comfortably as possible with those of the other economic regulators.

This may be achieved by considering whether proposed new standards or practices have consequential changes for existing APRA regulation. In addition, avoiding the duplication of the supervisory activities of other regulators, and considering whether outcomes could be achieved by utilising existing regulation administered by another regulator, would ensure an integrated regulatory framework. APRA should also consider the outcomes or recommendations of relevant Government-established panels, reviews or inquiries.

The Government also considers it important that APRA's standards and practices support Australia's financial sector in globally integrated markets through the consideration of regulatory frameworks in other jurisdictions.

In addition, by engaging actively with international regulatory counterparts, APRA should assist in monitoring the integrity and management practices of multinational financial institutions and in minimising regulatory barriers to trade in financial services.

APRA's role in providing technical and other assistance to its regulatory counterparts is also important in enhancing standards and practices in the Asian and Pacific regions.

Transparency and Accountability

APRA was established as an independent body to administer the prudential regulatory framework. However, APRA performs its statutory functions as part of the Australian Government and remains accountable to the Parliament, and ultimately to the public, through the Treasury Ministers, the Parliamentary Committee process and the tabling of its annual report. Open consultation and a sound working relationship with the entities that it supervises should help to ensure that APRA interacts with market participants and the community more generally in a transparent and accountable manner.

It is important that industry participants are encouraged to communicate considered and candid views to APRA. Engaging effectively with industry early in the development of prudential standards and guidelines can enhance the regulatory framework and outcomes. The overall objectives of stakeholder consultations are to ascertain the impact of regulation, enhance the efficiency and effectiveness with which regulation objectives are achieved, increase understanding of the context of regulatory changes within the overall legislative and regulatory framework, as well as increase understanding of the regulatory implications of structural changes and developments in the financial sector.

The Government has accepted a number of the recommendations of the Banks Report, the speedy implementation of which will improve the transparency and accountability of APRA's operations.

Joint industry consultative body

Recommendation 5.12 of the Banks Report recommended that APRA and ASIC convene a joint industry consultative body, with membership drawn from the key sectors regulated by APRA or ASIC and the regulators themselves.

The Government encourages APRA and ASIC to cooperate and liaise with each other, and industry representatives, to identify and explore possible mechanisms to provide industry with the opportunity to raise issues about how regulatory coordination operates in practice. I note that APRA's working group with ASIC is continuing to review areas of regulatory overlap and duplication, including financial reports, licensing requirements and breach notifications, and look forward to the issuing of a joint progress report in the near future.

Service charter

Recommendation 5.13 of the Banks Report recommended that APRA, in consultation with Government and industry, develop an industry charter, setting out the key rights and responsibilities of APRA and its regulated entities. The principal objective of the charter should be to clarify key expectations of both the regulated entity and the regulator, to enhance transparency and accountability.

The Government encourages APRA to implement this recommendation. I have asked Treasury to work with APRA in developing a charter.

Operational Issues

The requirements for APRA's financial management are set out in the *Commonwealth Authorities and Companies Act 1997* and the Finance Minister's Orders. In this regard, I note that it is the intention of the Government to make APRA an agency under the *Financial Management and Accountability Act 1997* as soon as practicable.

It is Government policy that all departments and portfolio bodies should continue efforts to secure improved efficiency in their operations and demonstrate value for money for the services that they deliver. I appreciate that APRA continues to seek opportunities to achieve outcomes in a more cost effective manner.

Conclusion

In conclusion, the Government's vision is that APRA remain a high performing and responsive agency that administers a principles-based regulatory framework in a manner that is efficient and effective, and that balances the objectives of financial safety and efficiency, competition, contestability and competitive neutrality. The framework should continue to facilitate innovation and enterprise, contributing to economic efficiency and growth. I look forward to working with APRA under a new era of enhanced governance arrangements.

I have copied this correspondence to the Prime Minister and the Minister for Finance and Administration.

Yours sincerely

PETER COSTELLO

Australian Prudential Regulation Authority

400 George Street (Level 26)
Sydney NSW 2000

GPO Box 9836
Sydney NSW 2001

T [illegible]
F [illegible]
W www.apra.gov.au

John F Laker
Chairman

APRA

18 May 2007

The Hon Peter Costello, MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer,

APRA STATEMENT OF INTENT

Your letter of 20 February 2007 provides your Statement of Expectations for the Australian Prudential Regulation Authority (APRA). It outlines the Government's current objectives in the area of prudential regulation and the Government's expectations for APRA with regards to its conduct, role and responsibilities, relationship with the Government and issues of transparency, accountability and operation.

We welcome your assurance that the Government recognises and will continue to respect the operational independence of APRA. We also welcome your indication that the Government is very pleased with the overall performance of APRA as a key economic regulator.

This letter in response sets out APRA's Statement of Intent in pursuing its mandate.

The Role and Responsibilities of APRA

APRA is responsible for supervising banks, credit unions, building societies, life and general insurance and reinsurance companies, friendly societies and superannuation funds (except self-managed superannuation funds). These institutions currently hold approximately $2.5 trillion in assets for 20 million Australian depositors, policyholders and superannuation fund members (APRA's 'beneficiaries').

Since its establishment in 1998, APRA's activities have been guided by the vision, mission and supervisory approach endorsed by APRA's original Board and re-confirmed by its Executive Group. These aspirations are fully consistent with the Statement of Expectations.

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

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

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

APRA's **supervisory approach** is forward-looking, primarily risk-based, consultative, consistent and in line with international best practice.

APRA's supervisory approach is based on the fundamental premise that the primary responsibility for financial soundness and prudent risk management within a supervised financial institution rests with its board of directors and senior management. APRA's role is to promote prudent behaviour by financial institutions through a robust prudential framework of legislation, prudential standards and prudential guidance, which aims to ensure that risk-taking is conducted within reasonable bounds and that risks are clearly identified and well managed.

In doing so, APRA does not pursue a zero failure objective. APRA cannot eliminate completely the risk that a financial institution might fail and it recognises that any attempt to do so would impose unnecessary burden on financial institutions and harden the arteries of the financial system. APRA fully endorses the view of the Statement of Expectations that "...prudential regulation cannot and should not seek to guarantee a zero failure rate of prudentially regulated institutions or provide absolute protection for market participants (including consumers)."

The Statement of Expectations confirms the objective that the prudential regulation regime maintain a low incidence of failure of regulated entities while not impeding continued improvement in efficiency or hindering competition. APRA intends to achieve this objective through the setting of prudential requirements and its approach to the supervision of individual institutions.

In developing prudential requirements, APRA is committed to moving to a more flexible, principles-based approach, though detailed requirements are unavoidable in some areas. APRA's focus is on sound prudential outcomes, rather than rules and processes. APRA has always complied with the Government's policy on best practice regulation and will continue to do so by:

- consulting widely and in a transparent manner to ensure that all relevant views on proposed changes to requirements are properly considered;
- providing reasonable time for interested parties to provide comments on APRA's proposals;
- assessing the likely effects of the proposals and weighing them against the benefits our proposals are designed to achieve; and
- continually reviewing our prudential requirements so they remain relevant and effective in the context of market developments.

In this context, APRA is reviewing its guidance material with the aim of producing more detailed guidance, but not prescription, on prudent practice and on how supervised institutions might comply with APRA's requirements. This is fully consistent with the recommendation of the Report of the *Taskforce on Reducing Regulatory Burden on Business* (the Banks Report).

In supervising individual financial institutions, APRA has developed a risk-based approach under which institutions facing greater risks receive closer supervisory attention. This enables APRA to deploy its resources in a targeted and cost-effective manner. The risk-based approach involves:

- licensing only those institutions that are likely to be able to meet their financial promises under all reasonable circumstances;

- regularly analysing the financial condition of institutions and reviewing their risk management to assess their relative risk of failure and whether they meet prudential requirements;
- responding to these assessments by tailoring APRA's supervisory activities to the risk profile of the institution; and
- if necessary, taking enforcement action to protect the interests of beneficiaries or to make it clear that illegal or materially imprudent behaviour will not be tolerated.

APRA's risk-based approach is underpinned by supervisory tools developed within APRA to ensure that risks are assessed rigorously and consistently, that critical warning signs are identified early and that our supervisory response is prompt and measured. APRA seeks to act pre-emptively, so that emerging threats to financial institutions are addressed before the interests of beneficiaries are damaged; where pre-emptive action is not possible, APRA's objective is to set in train appropriate wind-up or other exit strategies that minimise losses to beneficiaries.

APRA intends to continue its high standard of on-going prudential supervision through enhancements to its supervisory tools and through attracting, developing and retaining a high-calibre and motivated work-force. APRA welcomes the significant funding increases the Government has provided over recent years to sustain APRA's capabilities.

APRA also intends to continue using speeches by APRA members and senior executives, its regular *Insight* publication and other opportunities to explain its role and what the Australian community can expect from the prudential framework.

Collection of data

APRA is the national statistical agency for the Australian financial sector, having assumed the role of seven predecessor statistical collection units across the Commonwealth and State governments. Around 80 per cent of APRA's data collections are shared with or collected on behalf of other agencies, in particular the Reserve Bank of Australia (RBA) and the Australian Bureau of Statistics (ABS). This single collection point provides substantial efficiency benefits for reporting institutions. To ensure that collections appropriately balance cost and value, we meet regularly on a tripartite basis with the RBA and ABS to review the collections; we also consult regularly with industry.

APRA intends to maintain its high standard of data collection and analysis. A continuous improvement program has considerably enhanced the timeliness and accuracy of data and is now focussing on improving the usefulness of data for APRA, other agencies, industry and the public.

Early release of superannuation benefits

APRA plays a role in preserving the integrity of Australia's retirement incomes policy by approving early release of superannuation benefits on specified compassionate grounds. APRA has achieved improvements in turnaround times and service in this area and we intend to pursue further improvements. However, the volume of hardship cases can vary substantially from time to time with changes in economic conditions.

Key performance indicators

The Statement of Expectations encourages APRA to implement the recommendation of the Banks Report that APRA develop a broader suite of performance indicators, in addition to existing safety measures, consistent with its statutory responsibilities. APRA intends to do so.

APRA's Annual Report publishes two safety measures that are indicative of APRA's supervisory performance:

- the number (and ratio) of APRA-regulated institutions that met their commitments to beneficiaries in a given year (the Performing Entity Ratio); and
- the dollar value (and ratio) of liabilities to beneficiaries in Australia that remained safe in a given year (the Money Protection Ratio).

In addition, the Annual Report has published information on the transition of supervised institutions between APRA's different supervisory stances. This provides evidence of the effectiveness of APRA's proactive, risk-based supervisory approach in identifying and helping to resolve problems.

The development of meaningful performance indicators of the broader impact of prudential supervision is only at an embryonic stage, within APRA and globally. Measures of direct cost impacts can be produced but need to be carefully interpreted. Measuring the benefits of a robust prudential framework in underpinning confidence in financial institutions and the integrity of the Australian financial system is more challenging but must form part of any assessment of APRA's performance. APRA will continue its research in this area and stay abreast of global developments. Performance indicators will be finalised after consultations with Treasury, industry and other stakeholders.

Relationships between APRA and the Government

APRA acknowledges the importance of maintaining a high level of awareness of the Government's policy directions and objectives. To this end, it maintains regular contact with the offices of Treasury portfolio Ministers and is provided with advice by Treasury on a regular basis.

APRA will continue to provide you, and other Treasury portfolio Ministers as appropriate, with accurate and timely advice on significant matters in its core area of business and on problems APRA has identified in the course of performing its supervisory functions. In particular, APRA will ensure that it advises the Minister if it considers an APRA-regulated institution is in financial difficulty.

APRA intends to maintain its close working relationship with Treasury, which is underpinned by a Memorandum of Understanding between the two agencies and supported by regular coordination meetings between senior executives. APRA and Treasury also liaise closely on the development of the prudential framework and on issues associated with the legislation that APRA administers.

APRA also intends to maintain effective and cooperative working relationships, underpinned by Memoranda of Understanding, with a number of other Commonwealth and State agencies, including all those specifically mentioned in the Statement of Expectations. APRA has particularly close working arrangements with the RBA and the Australian Securities and Investments Commission (ASIC), involving regular meetings and contacts at senior executive and operational levels to deal, as appropriate, with individual institution issues, broader regulatory matters and developments in the financial system. APRA will also continue to play an active role in the Council of Financial Regulators.

Consistent with its aim of being a world-class integrated prudential supervisor, APRA intends to retain an active role in international groups and forums for banking, insurance and pensions. This involvement allows APRA to stay in tune with international developments and to bring an Australian perspective to global efforts to harmonise the international prudential supervision framework. Constructive relationships with senior people in overseas prudential regulators also assist us in our prudential oversight of APRA-regulated institutions operating internationally.

APRA is regarded as a leading supervisory agency in the Asian and Pacific regions, and more broadly, and it provides a range of technical and other assistance to prudential supervisors in these regions. Subject to resourcing, APRA intends to continue this role.

Transparency and Accountability

Through its supervisory activities, APRA has frequent contact with boards and senior executives of individual institutions; it also liaises regularly with the main industry associations and professional bodies in the financial sector. These contacts enable us to keep up-to-date on industry developments and issues, and provide effective communication channels for industry participants to raise issues candidly with APRA. APRA intends to maintain and, where it can, strengthen these contacts, in line with the importance attached by the Statement of Expectations to open consultation and a sound working relationship between APRA and the institutions that it supervises.

In the Statement of Expectations, the Government has encouraged APRA and ASIC to explore, with industry representatives, possible mechanisms to provide industry with the opportunity to raise issues about how regulatory coordination operates in practice. The two agencies have invited the Finance Industry Council of Australia (FICA), an umbrella body for a number of finance industry associations, to regular joint meetings with APRA Members and ASIC Commissioners to discuss emerging industry and supervisory issues and regulatory coordination. Other industry associations will also be invited to participate.

APRA and ASIC have also formed a joint working group to review their respective administrative practices and to evaluate how any overlaps, inconsistencies or duplication might be reduced. A progress report was issued in February 2007. This work has clarified that APRA and ASIC follow distinct and complementary missions and that areas of overlap are relatively minor. Nevertheless, APRA intends to continue working with ASIC on improving efficiencies and reducing duplication, with current efforts focussed on data collection, breach reporting and audit requirements.

APRA is preparing a Service Charter that sets out the key rights and responsibilities of APRA, its regulated institutions and members of the community who have dealings with APRA. The Service Charter will be finalised after consultations with Treasury, industry and other stakeholders.

Operational Issues

APRA will become an agency under the *Financial Management and Accountability Act 1997* from 1 July 2007. Within that framework, APRA will continue to seek opportunities to achieve outcomes in a more cost effective manner.

Conclusion

As Australia's prudential regulator, APRA plays a critical role in protecting the financial well-being of the Australian community and it is committed to carrying out this role in a vigilant, vigorous and effective way. Working with the Government, it has developed a prudential framework closely in line with international standards and at the forefront of best practice in some areas. Within that framework, APRA has sought to achieve a high level of financial safety for beneficiaries without unduly impairing the Australian financial system's efficiency, competitiveness or contestability.

We believe that this approach, focussed on outcomes, accords fully with the Government's vision for APRA set out in the Statement of Expectations. We look forward to a continued constructive relationship with the Government in the pursuit of a strong, robust and vibrant financial system in which the Australian community can place its confidence.

I have copied this correspondence to the Prime Minister, the Minister for Revenue and Assistant Treasurer, and the Minister for Finance and Administration.

Yours sincerely,

Statement by Members

In our opinion, the attached financial statements for the year ended 30 June 2007 are based on properly maintained financial records and give a true and fair view of the matters required by the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*.

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

Dr John F. Laker	Mr K. Ross Jones	Mr John Trowbridge
Chairman	Deputy Chairman	Member
30 August 2007	30 August 2007	30 August 2007

Financial statements 8

Income Statement for the year ended 30 June 2007

	Note	2007 $'000	2006 $'000
Income			
Revenue			
Revenue from Government	4A	**97,832**	81,637
Sale of goods and rendering of services	4B	**5,306**	6,937
Interest	4C	**3,608**	2,573
Rental income		**737**	816
Other revenue	4D	**645**	3,089
Total revenue		**108,128**	95,052
Gains			
Sale of assets	4E	**11**	–
Other gains	4F	**22**	–
Total gains		**33**	–
Total income		**108,161**	95,052
Expenses			
Employee benefits	5A	**61,001**	60,051
Suppliers	5B	**26,737**	26,981
Depreciation and amortisation	5C	**3,272**	3,934
Finance costs	5D	**–**	234
Write-down and impairment of assets	5E	**24**	908
Losses from asset disposals	5F	**28**	–
Total expenses		**91,062**	92,108
Operating surplus		**17,099**	2,944

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

Balance Sheet for the year ended 30 June 2007

	Note	2007 $'000	2006 $'000
Assets			
Financial assets			
Cash and cash equivalents	6A, 17B	**46,626**	13,432
Trade and other receivables	6B, 17B	**1,892**	2,803
Investments (s18 CAC Act)	6C, 17B	**–**	14,848
Total financial assets		**48,518**	31,083
Non-financial assets			
Infrastructure, plant and equipment	7A, 7B	**5,102**	4,426
Intangibles	7C, 7D	**3,419**	3,510
Other non-financial assets	7E	**902**	741
Total non-financial assets		**9,423**	8,677
Total assets		**57,941**	39,760
Liabilities			
Payables			
Suppliers	8A, 17B	**–**	2,788
Other payables	8B, 17B	**3,511**	1,587
Unearned fees and charges	8B, 17B	**2,079**	674
Total payables		**5,590**	5,049
Provisions			
Employee provisions	9A	**17,245**	16,054
Other provisions	9B	**2,303**	2,954
Total provisions		**19,548**	19,008
Total liabilities		**25,138**	24,057
Net assets		**32,803**	15,703
Equity			
Contributed equity		**3,155**	3,155
Reserves		**6,368**	367
Retained surpluses		**23,280**	12,181
Total equity		**32,803**	15,703
Current assets		**49,420**	31,824
Non-current assets		**8,521**	7,936
Current liabilities		**20,347**	19,226
Non-current liabilities		**4,791**	4,831

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

Statement of Changes in Equity for the year ended 30 June 2007

	Accumulated results 2007 $'000	Accumulated results 2006 $'000	Asset revaluation reserve 2007 $'000	Asset revaluation reserve 2006 $'000	Contingency Enforcement Fund 2007 $'000	Contingency Enforcement Fund 2006 $'000	Contributed equity 2007 $'000	Contributed equity 2006 $'000	Total equity 2007 $'000	Total equity 2006 $'000
Opening balance	12,181	9,649	367	1,123			3,155	6,155	15,703	16,927
Adjustment for errors[1]		(412)								(412)
Adjusted opening balance	12,181	9,237	367	1,123			3,155	6,155	15,703	16,515
Income and expense										
Revaluation adjustment			1[4]	(756)[2]					1	(756)
Sub-total income and expenses recognised directly in equity			1	(756)					1	(756)
Surplus (deficit) for the period	17,099	2,944							17,099	2,944
Total income and expenses	17,099	2,944	1	(756)					17,100	2,188
Transfers to reserves	(6,000)				6,000[5]				–	
Transaction with owners										
Distribution to owners										
Returns on capital										
Other								(3,000)[3]		(3,000)
Contributions by owners										
Appropriation (equity injection)										
Sub-total transactions with owners	(6,000)				6,000			(3,000)	–	(3,000)
Closing balance at 30 June	23,280	12,181	368	367	6,000		3,155	3,155	32,803	15,703

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

1 Relates to an accounting error in 2004/05

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

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

4 Revaluation of Canberra Office fit-out.

5 The Contingency Enforcement Fund has been set up to fund large and unexpected investigation and enforcement activities. The Fund will only be drawn on under the rules agreed with the Minister.

Statement of Cash Flows for the year ended 30 June 2007

	Note	2007 $'000	2006 $'000
Operating activities			
Cash received			
Appropriations		96,551	81,715
Goods and services		9,489	7,645
Interest		3,553	2,506
Net GST received		2,017	1,439
Rental income		737	815
Other cash received		673	3,089
Total cash received		113,020	97,209
Cash used			
Employees		(59,810)	(59,637)
Suppliers		(32,134)	(28,110)
Total cash used		(91,944)	(87,747)
Net cash from operating activities	10	21,076	9,462
Investing activities			
Cash received			
Investments		14,849	–
Proceeds from sale of assets		11	–
Total cash received		14,860	–
Cash used			
Purchase of plant and equipment		(1,282)	(2,108)
Investments (s18 CAC Act)		–	(4,929)
Purchase of intangibles		(1,460)	(1,017)
Total cash used		(2,742)	(8,054)
Net cash from investing activities		12,118	(8,054)
Financing activities			
Cash used			
Return 2004/05 appropriation (unused 2001/02 appropriation) to the Official Public Account		–	(3,000)
Total cash used		–	(3,000)
Net cash used by financing activities		–	(3,000)
Net increase/(decrease) in cash held		33,194	(1,592)
Cash at the beginning of the reporting period		13,432	15,024
Cash at the end of the reporting period	6A	46,626	13,432

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

Schedule of Commitments as at 30 June 2007

	2007 $'000	2006 $'000
By type[1]		
Capital commitments	–	–
Total capital commitments	–	–
Other commitments		
Operating leases	11,136	15,820
Operating sub-leases[2]	(56)	(725)
GST receivable	1,108	1,510
Total other commitments	12,188	16,605
Net commitments by type	12,188	16,605
Operating lease commitments		
One year or less	5,805	5,626
From one to five years	5,103	8,585
Over five years	172	884
GST receivable	1,108	1,510
Total operating lease commitments	12,188	16,605
Net commitments by maturity	12,188	16,605

Operating leases are non-cancellable and comprise:

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

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

[1] Commitments are GST-inclusive where relevant

[2] Comprises amounts receivable from other bodies for sub-leasing of office accommodation

Schedule of Contingencies as at 30 June 2007

	Note	2007 $'000	2006 $'000	2007 $'000	2006 $'000
		Claims for damages/costs		Total	
Contingent assets	11B				
Balance from previous period		–	26	–	26
New		–	–	–	–
Re-measurement		–	–	–	–
Assets crystallised		–	(26)	–	(26)
Expired		–	–	–	–
Total contingent assets		–	–	–	–
Contingent liabilities	11A				
Balance from previous period		(1,330)	(940)	(1,330)	(940)
New		–	(250)	–	(250)
Re-measurement		–	(140)	–	(140)
Liabilities crystallised		–	–	–	–
Obligations expired		–	–	–	–
Total contingent liabilities		(1,330)	(1,330)	(1,330)	(1,330)
Net contingent assets/(liabilities)		(1,330)	(1,330)	(1,330)	(1,330)

Details of each class of contingent liabilities and assets, including those not disclosed above because they cannot be quantified or are considered remote, are shown in Note 11: *Contingent liabilities and assets*.

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

Schedule of Administered Items

	Note	2007 $'000	2006 $'000
Income administered on behalf of Government			
for the year ended 30 June 2007			
Taxation revenue			
Financial Institutions Supervisory Levies	18A	113,010	98,302
Financial Assistance Levy	18A	(34)	3,042
Total taxation revenue		112,976	101,344
Total revenues administered on behalf of Government		112,976	101,344
Expenses administered on behalf of Government			
for the year ended 30 June 2007			
Supervisory Levy waivers and write-offs	18B	447	126
Other		308	(7)
Total expenses administered on behalf of Government		755	119
Assets administered on behalf of Government			
as at 30 June 2007			
Financial assets			
Cash	18C	–	–
Receivables – Supervisory Levies	18C	1,287	7
– Financial Assistance Levy	18C	(6)	315
Other	18C	–	(2)
Total assets administered on behalf of Government		1,281	320
Liabilities administered on behalf of Government			
as at 30 June 2007			
Total liabilities administered on behalf of Government		–	–

Schedule of Administered Items (continued)

	Note	2007 $'000	2006 $'000
Administered cash flows			
for the year ended 30 June 2007			
Operating activities			
Cash received			
Financial Institutions Supervisory Levies		110,974	98,481
Financial Assistance Levy		286	6,690
Cash received from Official Public Account for refunds		78	292
Total cash received		111,338	105,463
Cash used			
Refunds of overpayments of levies		(78)	(292)
Total cash used		(78)	(292)
Net cash from operating activities		111,260	105,171
Investing activities		–	–
Financing activities		–	–
Net increase (decrease) in cash held		111,260	105,171
Cash at the beginning of the reporting period		–	246
		111,260	105,417
Cash to Official Public Account		(111,260)	(105,417)
Cash at the end of the reporting period		–	–

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 1.20). Transactions and balances relating to levies are reported in Note 18 as *Administered items*.

Administered reconciliation table

for the year ended 30 June 2007

	2007 $'000	2006 $'000
Opening administered assets less administered liabilities	320	4,220
Plus administered revenues	112,976	101,344
Minus administered expenses	(755)	(119)
Administered transfers to/from Australian Government:		
Net transfers to Official Public Account	(111,260)	(105,125)
Closing administered assets less administered liabilities	1,281	320

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 2007

Note	Description
1	Summary of significant accounting policies
2	Events after the balance sheet date
3	Calculation of APRA Special Appropriation
4	Income
5	Operating expenses
6	Financial assets
7	Non-financial assets
8	Payables
9	Provisions
10	Cash flow reconciliation
11	Contingent liabilities and assets
12	Remuneration of APRA Members
13	Related party disclosures
14	Executive remuneration
15	Remuneration of auditors
16	Average staffing levels
17	Financial instruments
18	Administered items
19	Appropriations
20	Compensation and debt relief
21	Assets held in trust
22	Special account
23	Reporting of outcomes

Note 1. Summary of significant accounting policies

1.1 Basis of preparation of the financial statements

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

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

The statements have been prepared in accordance with:

- Finance Minister's Orders (FMOs), being the *Commonwealth Authorities and Companies Orders (Financial Statements for reporting periods ending on or after 1 July 2006)*; and
- Australian Accounting Standards and interpretations issued by the Australian Accounting Standards Board (AASB) that apply for the reporting period.

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

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

Unless alternative treatment is specifically required by an accounting standard or the FMOs, assets and liabilities are recognised in the Balance Sheet when and only when it is probable that future economic benefits will flow and the amounts of the assets or liabilities can be reliably measured. However, assets and liabilities arising under agreements equally proportionately unperformed are not recognised unless required by an accounting standard. Liabilities and assets that are unrecognised are reported in the *Schedule of Commitments* and the *Schedule of Contingencies* (other than unquantifiable or remote contingencies, which are reported at Note 11).

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

Administered revenues, expenses, assets, liabilities and cash flows reported in the *Schedule of Administered Items* and related notes are accounted for on the same basis and using the same policies as for Authority items, except where stated in Note 1.20.

1.2 Significant accounting judgments and estimates

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

- the fair value of leasehold improvements has been taken to be the market value of similar installations as determined by an independent valuer in 2005 and reviewed at year end. Canberra leasehold improvements were valued at market value by an independent valuer in June 2007.

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

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

1.3 Statement of compliance

Australian Accounting Standards require a statement of compliance with International Financial Reporting Standards (IFRS) to be made where the financial report complies with these standards. Some Australian equivalents to IFRS and other Australian Accounting Standards contain requirements specific to not-for-profit entities that are inconsistent with IFRS requirements. APRA is a not-for-profit entity and has applied these requirements. Hence, this financial report complies with Australian Accounting Standards including Australian Equivalents to International Financial Reporting Standards (AEIFRS), but not fully with IFRS.

No accounting standard has been adopted earlier than the effective date in the current period. APRA is required to disclose Australian Accounting Standards that have not been applied, and standards that have been issued but are not yet effective.

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

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

Title	Standard affected	Application date*	Nature of impending change	Impact expected on financial report
2005-10	AASB132, AASB101, AASB114, AASB117, AASB133, AASB139, AASB1, AASB1023 and AASB1038	1 Jan 2007	Amends requirements subsequent to the issuing of AASB7.	No expected impact.
2006-10	AASB7 Financial instruments: disclosures	1 Jan 2007	Revises the disclosure requirements for financial instruments from AASB132 requirements.	No expected impact.

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

1.4 Revenue

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

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

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

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

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

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

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

Revenues from Government

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

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

Resources received free of charge

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

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

There were no resources received free of charge in 2006/07 (2005/06: $Nil).

1.5 Transactions with the Government as owner

Equity injections

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

Other distributions to owners

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

1.6 Employee benefits

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

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

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

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

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

Leave

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

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

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

Separation and redundancy

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

Superannuation

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

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

For all other employees, employer contributions are made to other superannuation (accumulation) funds, as nominated by the employee (see Note 5A).

The liability for superannuation recognised at 30 June 2007 represents outstanding contributions for the final fortnight of the year.

1.7 Leases

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

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

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

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

1.8 Borrowing costs

All borrowing costs are expensed as incurred.

1.9 Cash

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

1.10 Financial risk management

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

1.11 Investments

Investments are initially measured at cost.

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

- receivables which are measured at amortised cost using the effective interest method; and
- held-to-maturity investments which are measured at amortised cost using the effective interest method.

1.12 Derecognition of financial assets and liabilities

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

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

1.13 Impairment of financial assets

Financial assets are assessed for impairment at each balance date.

Financial assets held at amortised cost

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

Financial assets held at cost

If there is objective evidence that an impairment loss has been incurred that is not carried at fair value because it cannot be reliably measured, the amount of the impairment loss is the difference between the carrying amount of the asset and the present value of the future cash flows discounted at the current market rate for similar assets.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

1.14 Supplier and other payables

Supplier and other payables 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).

1.15 Contigent liabilities and contigent assets

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

1.16 Acquisition of assets

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

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

1.17 Property (infrastructure), plant and equipment

Asset recognition threshold

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

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

Revaluations

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

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

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

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

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

Depreciation and amortisation

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

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

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

Asset class	**2007**	2006
Computer hardware and office equipment	**3 to 12 years**	3 to 12 years
Leasehold improvements	**Lesser of 10 years or lease term**	Lesser of 10 years or lease term

Impairment

All assets were assessed for impairment at 30 June 2007. Where indications of impairment exist, the asset's recoverable amount is estimated and an impairment adjustment made if the asset's recoverable amount is less than its carrying amount.

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

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

1.18 Intangibles

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

Software is amortised on a straight-line basis over its anticipated useful life. The useful lives of APRA's software are the lesser of five years or assessed useful life (2006: Lesser of five years or assessed useful life).

All software assets were assessed for indications of impairment at 30 June 2007.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

1.19 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.

1.20 Reporting of administered activities

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

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

Administered cash transfers to and from the Official Public Account

Revenue collected by APRA for use by the Government rather than by the Authority is administered revenue. Collections are transferred to the Official Public Account (OPA) maintained by the Department of Finance and Administration. Conversely, cash is drawn from the OPA to make payments under Parliamentary appropriation on behalf of the Government. These transfers to and from the OPA are adjustments to the administered cash held by the Authority on behalf of the Government and reported as such in the *Administered Cash Flows*, in the *Schedule of Administered Items* and in the *Administered reconciliation table* in Note 18D. Thus the *Schedule of Administered Items* largely reflects the Government's transactions through the Authority with parties outside the Government.

Revenue

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

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

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

Expenses

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

Waivers of levies under the *Financial Institutions Supervisory Levies Collection Act 1998* are shown at Note 20, 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. Events after the balance sheet date

From 1 July 2007, APRA will cease to operate under the *Commonwealth Authorities and Companies Act 1997* and instead will operate under the *Financial Management and Accountability Act 1997* (FMA Act). The *Australian Prudential Regulation Act 1998* has been amended to establish a Special Account in accordance with section 21 of the FMA Act.

As a result of this change, APRA liquidated all its investments and transferred all cash ($46.6m) to the Consolidated Revenue Fund on 29 June 2007. This cash became the opening balance of the Special Account as at 1 July 2007.

Note 3. Calculation of APRA Special Appropriation

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

Details are as follows:

	2007 $'000	2006 $'000
Table 1: Summary		
Current year levies and penalties (see note 18A, Table 1)	113,010	98,302
Less: Waivers, write-offs and doubtful debts (see Note 18B)	(755)	(126)
Net current year levies and penalties (see Table 2 below)	112,255	98,176
Less: Amounts retained in the CRF (see Table 3 below)	(16,900)	(17,539)
Total APRA Special Appropriation (see Table 4 below)	95,355	80,637
Table 2: Net current year levies and penalties by levy type		
Superannuation funds	48,588	41,476
Authorised deposit-taking institutions	33,068	30,099
Life insurers and friendly societies	9,048	9,752
General insurers	21,551	16,849
Total net current year levies and penalties	112,255	98,176
Table 3: Amounts retained in the CRF by levy type[1]		
Superannuation funds	(12,008)	(12,089)
Authorised deposit-taking institutions	(1,984)	(2,210)
Life insurers and friendly societies	(1,580)	(1,760)
General insurers	(1,328)	(1,480)
Total amount retained in CRF	(16,900)	(17,539)
Table 4: Equivalent amounts of levy payable to APRA under the APRA Special Appropriation by levy type		
Superannuation funds	36,580	29,387
Authorised deposit-taking institutions	31,084	27,889
Life insurers and friendly societies	7,468	7,992
General insurers	20,223	15,369
Total APRA Special Appropriation	95,355	80,637

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

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 4. Income

	2007 $'000	2006 $'000
Note 4A. Revenue from Government		
Special Appropriation (see Note 3)	95,355	80,637
Other	2,477	1,000
Total revenue from Government	97,832	81,637
Note 4B. Sale of goods and rendering of services		
Rendering of services – related entities	1,372	766
Rendering of service – external entities	3,934	6,171
Total rendering of services	5,306	6,937
Note 4C. Interest		
Deposits	828	654
Commonwealth and State Government securities	2,780	1,919
Total interest	3,608	2,573
Note 4D. Other Revenue		
Licence fees from finance sector entities	438	227
Superannuation trustee applications	60	2,662
Fees from foreign bank representative offices	113	70
Other revenue relating to recovery of prior year court costs and prior year compensation matters	–	6
Recovery from Reserve Bank of Australia for Scholarship	17	14
Other recoveries	17	110
Total other revenue	645	3,089
Note 4E. Sale of assets		
Sale of assets	11	–
Total sale of assets	11	–
Note 4F. Other gains		
Writeback of makegood expense	22	–
Total other gains	22	–

Note 5. Operating expenses

	2007 $'000	2006 $'000
Note 5A. Employee benefits		
Salaries and wages	49,529	50,333
Superannuation	8,882	7,146
Leave and other entitlements	2,033	2,041
Separation and redundancy	88	311
Other employee expenses (see Note 1.6)	469	220
Total employee expenses	61,001	60,051
Note 5B. Supplier expenses		
Provision of goods – external entities	3,435	2,930
Rendering of services – related entities	3,883	5,564
Rendering of services – external entities	12,860	12,089
Operating lease rentals:		
– Minimum lease payments	6,299	6,177
Workers' compensation premiums	260	221
Total supplier expenses	26,737	26,981
Note 5C. Depreciation and amortisation		
Depreciation		
Computer hardware	486	741
Leasehold improvements	1,240	1,272
Amortisation		
Intangibles – computer software	1,546	1,921
Total depreciation and amortisation	3,272	3,934
Note 5D. Finance costs		
Unwinding of discount	–	234
Total finance costs	–	234
Note 5E. Write-down and impairment of assets		
Impairment of internally developed software	5	461
Write-down of infrastructure, plant and equipment	19	447
Total write-down and impairment of assets	24	908
Note 5F. Losses from assets disposal		
Computer hardware	19	–
Office fit-out	9	–
Total losses from assets disposal	28	–

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 6. Financial assets

	2007 $'000	2006 $'000
Note 6A. Cash and cash equivalents		
Cash on hand	46,626	13,431
Deposits at call	–	1
Total cash and cash equivalents	46,626	13,432
Note 6B. Trade and other receivables		
Goods and services	134	2,264
Special Appropriation	1,614	26
	1,748	2,290
GST receivable from the Australian Taxation Office	259	376
Interest receivable	211	157
Total trade and other receivables (gross)	2,218	2,823
Less: allowance for doubtful debts -		
Goods and services	–	(1)
Special Appropriation	(326)	(19)
Total trade and other receivables (net)	1,892	2,803
Receivables are aged as follows:		
Not overdue	1,892	1,311
Overdue by:		
– less than 30 days	–	1,486
– 30 to 60 days	–	1
– 60 to 90 days	–	1
– more than 90 days	326	24
	326	1,512
Total receivables (gross)	2,218	2,823
The allowance for doubtful debts is aged as follows:		
Not overdue	–	–
Overdue by:		
– less than 30 days	–	–
– 30 to 60 days	–	–
– 60 to 90 days	–	–
– more than 90 days	(326)	(20)
Total allowance for doubtful debts	(326)	(20)

Note 6. Financial assets (continued)

	2007 $'000	2006 $'000
Note 6B. Trade and other receivables (continued)		
Receivables are represented by		
Current	1,892	2,803
Non-current	–	–
Total trade and other receivables (net)	1,892	2,803
Note 6C. Investments under s18 of the CAC Act		
Securities of Australian Government, States and Territories (see Note 2)	–	14,848
Total investments	–	14,848

Note 7. Non-financial assets

	2007 $'000	2006 $'000
Note 7A. Infrastructure, plant and equipment		
Computer hardware and office equipment		
– fair value	1,780	1,307
– accumulated depreciation	(987)	(526)
– work in progress	1,276	192
Total computer hardware and office equipment	2,069	973
Leasehold improvements		
– fair value	4,969	4,536
– accumulated amortisation	(2,099)	(1,120)
– work in progress	163	37
Total leasehold improvements	3,033	3,453
Total infrastructure, plant and equipment (non-current)	5,102	4,426

All assets were assessed for impairment at 30 June 2007 using internal expertise. The fit-out of Canberra Office was valued in June 2007 by an independent valuer owing to renewal of the lease.

No indicators of impairment were found for infrastructure, plant and equipment.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 7. Non-financial assets (continued)

Note 7B. Reconciliation of infrastructure, plant and equipment at valuation

	$'000 Computer hardware and office equipment	$'000 Leasehold improvements	$'000 Total
As at 1 July 2006			
Gross book value	**1,499**	**4,573**	**6,072**
Accumulated depreciation/amortisation	(526)	(1,120)	(1,646)
Net book value 1 July 2006	**973**	**3,453**	**4,426**
Additions:			
by purchase	1,601	847	2,448
Net revaluation increment/(decrement)	–	1	1
Depreciation/amortisation expense	(486)	(1,240)	(1,726)
Disposals:			
Other disposals by sale and write-off (net book value)	(19)	(28)	(47)
As at 30 June 2007			
Gross book value	3,056	5,132	8,188
Accumulated depreciation/amortisation	(987)	(2,099)	(3,086)
Closing net book value	2,069	3,033	5,102

Note 7C. Intangible assets

	2007 $'000	2006 $'000
Computer software at cost:		
– internally developed – in progress	880	82
– purchased – in progress	–	195
– internally developed – in use	7,517	7,427
– purchased – in use	3,538	2,883
	11,935	10,587
Accumulated amortisation	(8,516)	(7,077)
Total intangibles (non-current)	3,419	3,510

Note 7. Non-financial assets (continued)

	$'000 Computer software internally developed	$'000 Computer software purchased	$'000 Total
Note 7D. Reconciliation of intangibles			
As at 1 July 2006			
Gross book value	7,509	3,078	10,587
Accumulated amortisation	(5,415)	(1,662)	(7,077)
Net book value 1 July 2006	2,094	1,416	3,510
Additions:			
Purchase or internally developed	889	571	1,460
Amortisation	(1,071)	(475)	(1,546)
Disposals:			
Other disposals	–	(5)	(5)
As at 30 June 2007			
Gross book value	**8,397**	**3,538**	**11,935**
Accumulated amortisation	**(6,485)**	**(2,031)**	**(8,516)**
Closing net book value	**1,912**	**1,507**	**3,419**

	2007 $'000	2006 $'000
Note 7E. Other non-financial assets		
Prepayments	**902**	741
Total other non-financial assets	**902**	741

All other non-financial assets are current assets.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 8. Payables

	2007 $'000	2006 $'000
Note 8A. Suppliers		
Trade creditors	–	2,788
Total supplier payables	–	2,788

All supplier payables are current liabilities.

	2007 $'000	2006 $'000
Note 8B. Other payables		
Accrued expenses	3,485	1,481
Unearned fees and charges	2,079	674
GST payable to the ATO	26	106
Total other payables	5,590	2,261

All other payables are current liabilities.

Note 9. Provisions

	2007 $'000	2006 $'000
Note 9A. Employee provisions		
Salaries and wages	3,438	3,120
Leave	13,721	12,910
Other	86	24
Total employee provisions	17,245	16,054
Current	14,345	13,640
Non-current	2,900	2,414
	17,245	16,054
Note 9B. Other provisions		
Lease incentive	612	1,153
Provisions for 'make good'	1,691	1,801
Total other provisions	2,303	2,954
Current	412	537
Non-current	1,891	2,417
	2,303	2,954

Note 9. Provisions (continued)

	$'000 Lease incentive	$'000 Provision for 'make good'	$'000 Total
Carrying amount 1 July 2006	1,153	1,801	2,954
Additional provisions made	–	23	23
Amounts used	(541)	(88)	(629)
Amounts reversed	–	(45)	(45)
Closing balance 30 June 2007	612	1,691	2,303

APRA leases premises in Sydney, Melbourne, Canberra, Brisbane, Perth and Adelaide.

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

Note 10. Cash flow reconciliation

	2007 $'000	2006 $'000
Reconciliation of cash as per *Balance Sheet* to *Statement of Cash Flows*:		
Cash at year-end as per *Statement of Cash Flows*	46,626	13,432
Balance Sheet items comprising the above cash:		
'Financial asset – cash and cash equivalents'	46,626	13,432
Reconciliation of operating result to net cash from operating activities:		
Operating result	17,099	2,944
Non-cash items		
Depreciation/amortisation	3,272	3,934
Net write-down of non-financial assets	19	1,236
Prior year adjustment	–	(412)
Net loss on disposal of assets	22	–
(Increase)/decrease in net receivables	938	196
(Increase)/decrease in prepayments	(161)	(222)
(Increase)/decrease in accrued revenue	(27)	(6)
Increase/(decrease) in revenue in advance	1,404	526
Increase/(decrease) in employees' provisions	1,191	635
Increase/(decrease) in suppliers' payables	(1,951)	(781)
Increase/(decrease) in other provisions	(730)	1,412
Net cash from operating activities	21,076	9,462

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 11. Contingent liabilities and assets

Note 11A. Quantifiable contingent liabilities

At 30 June 2007, the Authority was engaged in a number of legal actions brought against it by various parties relating to disqualification of persons as trustees or to hold positions of responsibility in the general insurance industry, review of decisions by the Administrative Appeals Tribunal and actions brought by APRA against parties in relation to enforcement of the requirements of the legislation administered by APRA. The costs that might be incurred relate mainly to legal counsel and those associated with the legal proceedings. The quantum of the liabilities has been based on estimates provided by the legal practitioners representing the Authority.

Note 11B. Quantifiable contingent assets

As stated in Note 11A, the Authority is engaged in a number of legal cases at 30 June 2007. 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.

Unquantifiable contingencies

Of the legal matters unresolved at 30 June 2007, a number of the cases were at a stage where it was not possible to quantify the amounts of any eventual payments that may be required in relation to these claims.

Note 12. Remuneration of APRA Members

APRA Members are appointed by the Governor-General under Part 3 of the *Australian Prudential Regulation Authority Act 1998* and remuneration is set by the Remuneration Tribunal under the R*emuneration Tribunal Act 1973*. Total remuneration as determined by the Tribunal for 2006/07 was Chairman $554,950 (2005/06: $531,470); Deputy Chairman $464,340 (2005/06: $444,700); and Member $441,700 (2005/06: $423,010). Any difference between the Tribunal determination and the cost to APRA reported below is due to: changes in unused annual and long service leave entitlements accumulated in the year; funding changes to defined benefit superannuation schemes where relevant; and the commencement of the new Member from August 2006. Prior year amounts have been restated to provide consistency with the treatment of superannuation in 2006/07.

Note 12. Remuneration of APRA Members (continued)

	2007 Number	2006 Number
The remuneration of APRA Members, measured in terms of the cost to APRA, is shown below in the relevant remuneration bands:		
$390,000 - $404,999	–	1
$420,000 - $434,999	1	–
$480,000 - $494,999	–	1
$510,000 - $524,999	1	–
$570,000 - $584,999	–	1
$650,000- $664,999	1	–
Total number of APRA Members	3	3
	$	$
Total remuneration of APRA Members, measured in terms of the cost to APRA:	1,590,530	1,465,143

Note 13. Related party disclosures

Transactions with APRA Member-related entities

There were no related entity transactions in 2006/07 (2005/06: $Nil) in respect of APRA Members.

Loans to APRA Members and Member-related entities

There were no loans made to APRA Members or Member-related entities in 2006/07 (2005/06: $Nil).

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 14. Executive remuneration

Prior year amounts have been restated to provide consistency with the treatment of superannuation in 2006/07.

	2007 Number	2006 Number
The remuneration of officers, measured in terms of the cost to APRA, is shown below in the relevant income bands:		
$175,000 – $189,999	–	1
$190,000 – $204,999	–	1
$205,000 – $219,999	1	5
$220,000 – $234,999	5	4
$235,000 – $249,999	7	6
$250,000 – $264,999	6	4
$265,000 – $279,999	–	1
$280,000 – $294,999	1	–
$295,000 – $309,999	–	–
$310,000 – $324,999	–	1
$325,000 – $339,999	1	1
$340,000 – $354,999	–	2
$355,000 – $369,999	2	1
$370,000 – $384,999	1	–
$385,000 – $399,999	–	–
$430,000 – $444,999	1	1
Total	25	28
	$	$
Total remuneration of executives, measured in terms of the cost to APRA:	6,760,180	7,258,033

Note 15. Remuneration of auditors

	2007 $'000	2006 $'000
The cost of financial statement audit services provided to the Authority was:		
Australian National Audit Office	110	96

No other services were provided by the Auditor-General.

Note 16. Average staffing levels

	2007	2006
The average staffing levels for the Authority during the year were:	551	592

Note 17. Financial instruments

Note 17A. Interest rate risk

		2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
	Note	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	%	%
Financial instrument		Floating interest rate		Fixed interest rate maturing in 1 year or less		Fixed interest rate maturing in 1 to 5 years		Fixed interest rate maturing in >5 years		Non-interest bearing		Total		Weighted average effective interest rate	
Financial assets															
Cash at bank	6A	46,624	13,430	–	–	–	–	–	–	–	–	46,624	13,430	5.80	5.19
Cash on hand	6A	–	–	–	–	–	–	–	–	2	2	2	2	n/a	n/a
Investments in Government securities	6C	–	–	–	14,848	–	–	–	–	–	–	–	14,848	n/a	5.41
Appropriations receivable	6B	–	–	–	–	–	–	–	–	1,288	7	1,288	7	n/a	n/a
Receivables for goods and services	6B	–	–	–	–	–	–	–	–	134	2,263	134	2,263	n/a	n/a
Accrued interest	6B	–	–	–	–	–	–	–	–	211	157	211	157	n/a	n/a
Other receivables	6B	–	–	–	–	–	–	–	–	259	376	259	376	n/a	n/a
Total financial assets (recognised)		46,624	13,430	–	14,848	–	–	–	–	1,894	2,805	48,518	31,083		
Total assets												57,941	39,760		
Financial liabilities															
Revenue in advance	8B	–	–	–	–	–	–	–	–	2,079	674	2,079	674	n/a	n/a
Trade creditors	8A,8B	–	–	–	–	–	–	–	–	3,511	4,375	3,511	4,375	n/a	n/a
Total financial liabilities		–	–	–	–	–	–	–	–	5,590	5,049	5,590	5,049		
Total liabilities												25,138	24,057		

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 17. Financial instruments (continued)

Note 17B. Fair values of financial assets and liabilities

	Note	2007 $'000	2007 $'000	2006 $'000	2006 $'000
		Total carrying amount	Aggregate fair value	Total carrying amount	Aggregate fair value
Financial assets					
Cash	6A	46,626	46,626	13,432	13,432
Government securities	6C	–	–	14,848	14,848
Receivables for goods and services	6B	1,892	1,892	2,803	2,803
Total financial assets		48,518	48,518	31,083	31,083
Financial liabilities (recognised)					
Trade creditors	8A,8B	3,511	3,511	4,375	4,375
Revenue in advance	8B	2,079	2,079	674	674
Total financial liabilities (recognised)		5,590	5,590	5,049	5,049

Note 17C. Credit risk exposures

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

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

All figures for credit risk referred to do not take into account the value of any collateral or other security.
This note also applies to APRA's administered financial instruments and is therefore not reproduced at Note 18.

Note 18: Administered items (continued)

Note 18A. – Income administered on behalf of Government

	2007 $000	2006 $000
Revenues		
Taxation		
Financial Institutions Supervisory Levies:		
Current year levies and penalties (see Table 1)[1]	113,010	98,302
Current year levies recognised in previous period	–	–
	113,010	98,302
Financial Assistance Levy and penalties (see Table 2)	(34)	3,042
Total revenues administered on behalf of Government	112,976	101,344

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

	2007 $000	2006 $000
Levy:		
Superannuation funds	49,191	41,528
Authorised deposit-taking institutions	33,068	30,099
Life insurers and friendly societies	9,048	9,752
General insurers	21,551	16,849
Total levies	112,858	98,228
Late payment penalties:		
Superannuation funds	152	69
Total late payment penalties	152	69
Late lodgement penalties:		
Superannuation funds	–	5
Total late lodgement penalties	–	5
Total current year levies and penalties	113,010	98,302

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

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

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 18: Administered items (continued)

Note 18A. – Income administered on behalf of Government

	2007 $000	2006 $000
Table 2: Financial Assistance Levy and penalties		
Levy No. 2001/02:1 (Superannuation)		
Levy	–	(1)
Penalties	–	–
		(1)
Levy No. 2001/02:2 (Superannuation)		
Levy	–	(14)
Penalties	–	–
		(14)
Levy No. 2002/03:1 (Superannuation)		
Levy	–	(174)
Penalties	–	26
		(148)
Levy No. 2003/04:1 (Superannuation)		
Levy	(2)	(29)
Penalties	–	–
	(2)	(29)
Levy No. 2004/05:1 (Superannuation)		
Levy	(35)	3,229
Penalties	3	5
	(32)	3,234
Total Financial Assistance Levy and penalties	(34)	3,042

Note 18. Administered items (continued)

Note 18B. Expenses administered on behalf of Government

	2007 $000	2006 $000
Expenses:		
Net write-down of assets		
Financial Institutions Supervisory Levies		
Levies and late payment penalties waived (Table 1) and Note 20	(447)	(111)
Levies and late payment penalties written-off (Table 2)	–	(15)
Other (doubtful debts)	(308)	7
Total expenses administered on behalf of Government	(755)	(119)

Table 1: Levies and late payment penalties waived by levy type

	2007 $000	2006 $000
Superannuation funds	(447)	(111)
	(447)	(111)

Table 2: Levies and late payment penalties written-off by levy type

	2007 $000	2006 $000
Superannuation funds	–	(15)
	–	(15)

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 18. Administered items (continued)

Note 18C. – Assets administered on behalf of Government

	2007 $000	2006 $000
Financial assets		
Cash		
Cash on hand	–	–
Receivables		
Financial Institutions Supervisory Levies		
Superannuation levies	1,613	26
Financial Assistance Levy	(6)	315
Other	–	(2)
Total receivables (gross)	1,607	339
Less: allowance for doubtful debts	(326)	(19)
Total financial assets (net)	1,281	320
Total assets administered on behalf of Government	1,281	320
Receivables are aged as follows:		
Not overdue	1,287	1
Overdue by:		
– less than 30 days	(6)	309
– 30 to 60 days	–	1
– 60 to 90 days	–	1
– more than 90 days	326	29
Total receivables (gross)	1,607	341
The allowance for doubtful debts is aged as follows:		
Not overdue	–	–
Overdue by:		
– less than 30 days	–	–
– 30 to 60 days	–	–
– 60 to 90 days	–	–
– more than 90 days	(326)	(19)
Total allowance for doubtful debts	(326)	(19)

Note 18. Administered items (continued)

Note 18D. – Administered reconciliation table

	2007 $'000	2006 $'000
Opening administered assets less administered liabilities at 1 July	320	4,220
Plus administered revenues	112,976	101,344
Less administered expenses	(755)	(119)
Plus transfers from Official Public Account for refunds	78	292
Less transfers to Official Public Account	(111,338)	(105,417)
Closing administered assets less administered liabilities as at 30 June	1,281	320

Note 18E. - Administered financial instruments

Administered interest rate risk

	Note	2007 $'000	2006 $'000	2007 $'000	2006 $'000
Financial instrument		Non-interest bearing		Total	
Financial assets					
Cash	18C	–	–	–	–
Receivables	18C	1,281	322	1,281	322
Other	18C	–	(2)	-	(2)
Total financial assets (recognised)		1,281	320	1,281	320
Total assets		1,281	320	1,281	320
Financial liabilities		–	–	–	–

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 19. Appropriations

The tables in Note 19A and Note 19B report on appropriations made by the Parliament out of the Consolidated Revenue Fund (CRF) in respect of the Authority. When received by the Authority, the payments made are legally the money of the Authority and do not represent any balance remaining in the CRF. Note 19C relates to a Special Appropriation, which is administered on behalf of the Government.

Note 19A. Acquittal of Authority to draw cash from the Consolidated Revenue Fund for Ordinary Annual Services Appropriations

	2007 $'000	2006 $'000	2007 $'000	2006 $'000
Particulars	Departmental outputs		Total	
Appropriation Act No. 1 (2006/07)				
Purpose: funding of APRA – Outcome 1				
Balance carried forward from previous year	–	–	–	–
Available for payments from CRF	3,687	1,000	3,687	1,000
Cash payments made out of CRF	(3,687)	(1,000)	(3,687)	(1,000)
Balance carried forward to next year	–	–	–	–

Note 19B. Acquittal of Authority to draw cash from the Consolidated Revenue Fund - Special Appropriations (limited amount)

	2007 $'000	2006 $'000	2007 $'000	2006 $'000
Particulars	Outcome 1		Total	
***Australian Prudential Regulation Authority Act 1998* – section 50**				
Purpose: funding of APRA				
Amount available carried from previous period	27	105	27	105
Prior year balance adjustment	(20)	(306)	(20)	(306)
Appropriation for reporting period	95,355	80,637	95,355	80,637
Available for payments	95,362	80,436	95,362	80,436
Cash payments made during the year	(94,075)	(80,409)	(94,075)	(80,409)
Amount available carried to the next period	1,287	27	1,287	27
Represented by: Appropriations receivable	1,287	27	1,287	27

Note 19. Appropriations (continued)

Note 19C. Acquittal of Authority to draw cash from the Consolidated Revenue Fund – Special Appropriations (refund provisions)

	2007 $'000	2006 $'000	2007 $'000	2006 $'000
Particulars	Administered		Total	
***Financial Management and Accountability Act 1997* – section 28**[1]				
Purpose: to refund overpayments of levies by financial institutions				
Cash payments made during the year	(78)	(292)	(78)	(292)
Total charged to Special Appropriation	(78)	(292)	(78)	(292)

Note 20. Compensation and debt relief

	2007 $	2006 $
77 waivers of amounts owing to the Commonwealth were made pursuant to section 12 of the *Financial Institutions Supervisory Levies Collection Act 1998* (2006:20)	447,429	111,639
	447,429	111,639

Note 21. 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 2007 is nil.

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

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 21. Assets held in trust (continued)

Tunstall Bond Superannuation Fund Trust Account

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

	2007 $'000	2006 $'000
Total held at beginning of period	–	369
Total receipts during reporting period	–	43
Total payments during reporting period	–	(412)
Total held by APRA at the end of the reporting period (cash)	–	–

Note 22. Special account

Superannuation Protection Account

This account was established under section 234 of the *Superannuation Industry (Supervision) Act 1993* to facilitate the payment and recovery of financial assistance provided to superannuation fund members suffering adverse outcomes resulting from fraud and misappropriation by fund trustees. There were no transactions to this account in 2006/07 (2005/06: $Nil). All financial assistance payments by Treasury and recoveries by APRA made to date have been transacted directly from and to the Consolidated Revenue Fund.

Note 23. Reporting of outcomes

Note 23A – Outcomes of the Authority

APRA is structured to meet the following outcome:

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

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

Note 23. Reporting of outcomes (continued)

Note 23B. – Net cost of outcome delivery

	2007 $'000	2006 $'000
	Outcome 1	
Expenses		
Administered	755	119
Departmental	91,062	92,108
Total expenses	91,817	92,227
Costs recovered from provision of goods and services to the non-government sector:		
Administered	–	–
Departmental	4,545	9,130
Total costs recovered	4,545	9,130
Other external revenues		
Administered:		
Financial Institutions Supervisory Levies	113,010	98,302
Financial Assistance Levy	(34)	3,042
Total Administered	112,976	101,344
Departmental:		
Sale of goods and services – to related entities	1,372	766
Interest	3,608	2,574
Revenue from sale of assets	–	–
Rental recoveries	737	815
Insurance recoveries and other revenue	645	130
Total Departmental (Authority)	6,362	4,285
Total other external revenues	119,338	105,629
Net cost/(contribution) of outcome	(32,066)	(22,532)

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

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

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2007

Note 23. Reporting of outcomes (continued)

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

	2007 $'000	2006 $'000	2007 $'000	2006 $'000	2007 $'000	2006 $'000	2007 $'000	2006 $'000
Outcome Group 1	Output 1.1.1 Policy development		Output 1.1.2 Surveillance program		Output 1.1.3 Prudential advice		Total	
Operating expenses								
Employees	7,503	7,987	51,424	50,262	2,074	1,802	61,001	60,051
Suppliers	3,289	3,588	22,539	22,584	909	809	26,737	26,981
Finance costs	–	31	–	196	–	7	–	234
Depreciation and amortisation	402	523	2,758	3,293	112	118	3,272	3,934
Write-down of assets	6	121	44	760	2	27	52	908
Total operating expenses	11,200	12,250	76,765	77,095	3,097	2,763	91,062	92,108
Funded by:								
Revenues from Government	12,033	10,858	82,472	68,330	3,326	2,449	97,831	81,637
Sale of goods and services	653	923	4,473	5,806	180	208	5,306	6,937
Rent recoveries	91	109	621	683	25	24	737	816
Interest	444	342	3,042	2,154	123	77	3,609	2,573
Other revenues	84	411	571	2,585	23	93	678	3,089
Total operating revenues	13,305	12,643	91,179	79,558	3,677	2,851	108,161	95,052

The Authority's outcome and outputs are described at Note 23A.

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

Note 23. Reporting of outcomes (continued)

Note 23D. – Administered revenues and expenses by outcome

	2007 $'000	2006 $'000
	Outcome1	
Administered revenues		
Financial Institutions Supervisory Levies	113,010	98,302
Financial Assistance Levy	(34)	3,042
Total administered revenues	112,976	101,344
Administered expenses		
Levies waived	447	111
Levies written-off	-	15
Financial Assistance Levy written-off	-	-
Other	308	(7)
Total administered expenses	755	119

The Authority's outcome and outputs are described at Note 23A.

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

Australian National
Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Minister for Revenue and Assistant Treasurer

<u>Scope</u>

We have audited the accompanying financial statements of the Australian Prudential Regulation Authority for the year ended 30 June 2007. The financial statements comprise: a statement by Members; income statement; balance sheet; statement of changes in equity; statement of cash flows; schedules of commitments, contingencies and administered items; a summary of significant accounting policies, and other explanatory notes.

The Responsibility of the Members for the Financial Statements

The Members are responsible for the preparation and fair presentation of the financial statements in accordance with Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997* and Australian Accounting Standards (including Australian Accounting Interpretations). This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

My responsibility is to express an opinion on the financial statements based on our audit. Our audit has been conducted in accordance with Australian National Audit Office Auditing Standards, which incorporate Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Australian Prudential Regulation Authority's preparation and fair presentation of the financial statements in designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Australian Prudential Regulation Authority's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Members, as well as evaluating the overall presentation of the financial statements.

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

I believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Independence

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

Auditor's Opinion

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

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

(b) give a true and fair view of the matters required by the Finance Minister's Orders including the Australian Prudential Regulation Authority's financial position as at 30 June 2007 and of its financial performance and its cash flows for the year then ended.

Australian National Audit Office

P Hinchey
Senior Director
Delegate of the Auditor-General

Sydney
30 August 2007

9 Statutory report

Statutory reporting requirements

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

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

Australian Prudential Regulation Authority Act 1998 (APRA Act)

Report under section 59

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

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

APRA did not appoint any ADI statutory managers or persons to conduct an investigation under Division 2 of Part II or section 61 of the *Banking Act 1959* during 2006/07. There were no continuing appointments during the year.

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

Exemption number	Date	Provision of SIS Act/regulations exempted
A61 of 2006	03/07/06	Regulation 7.03A
A62 of 2006	01/07/06	Regulations 4.16 and 4.17
A63 of 2006	13/07/06	Regulations 4.16 and 4.17
A64 of 2006	10/07/06	Regulations 4.16 and 4.17
A65 of 2006	14/07/06	Regulation 9.29(1)
A66 of 2006		Not issued
A67 of 2006	28/09/06	Regulations 4.16 and 4.17
A68 of 2006		Not issued
A69 of 2006	14/08/06	Revoke exemption A66 of 2006
A70 of 2006	14/08/06	Regulation 6.29
A71 of 2006	12/10/06	Revoke exemption no. 105
A72 of 2006		Not issued

Exemption number	Date	Provision of SIS Act / regulations exempted
A73 of 2006		Not issued
A74 of 2006		Not issued
A75 of 2006		Not issued
A76 of 2006		Not issued
A77 of 2006		Not issued
A78 of 2006		Not issued
A79 of 2006	29/08/06	Regulations 4.16 and 4.17
A80 of 2006	12/09/06	Regulations 4.16 and 4.17
A81 of 2006	22/09/06	Regulation 9.29(1)
A82 of 2006	05/10/06	Regulations 4.16 and 4.17
A83 of 2006	11/10/06	Regulation 9.04D(1)
A84 of 2006	27/10/06	Regulations 4.16 and 4.17
A85 of 2006	05/10/06	Revoke exemption A28 of 2006
A86 of 2006	05/10/06	Subsection 330(2)
A87 of 2006	09/10/06	Regulations 6.18(1) and 6.19(1)
A88 of 2006	10/11/06	Revoke exemption A83 of 2006
A89 of 2006	10/11/06	Regulation 9.04D(1)
A90 of 2006	27/10/06	Regulation 9.04D(1)
A91 of 2006	01/11/06	Regulation 4.16
A92 of 2006	31/10/06	Regulation 9.29(1)
A93 of 2006	31/10/06	Regulation 9.29(1)
A94 of 2006	20/11/06	Regulation 9.04D(1)
A95 of 2006	29/11/06	Regulation 5.08
A96 of 2006	21/12/06	Revoke exemption A86 of 2006
A97 of 2006	21/12/06	Subsection 93(4)(a)
A98 of 2006	28/12/06	Regulations 4.16 and 4.17

Exemption number	Date	Provision of SIS Act / regulations exempted
A99 of 2006	29/12/06	Regulation 4.16 and 4.17
A1 of 2007	19/01/07	Subregulation 6.17(2)
A2 of 2007		Not issued
A3 of 2007		Not issued
A4 of 2007		Not issued
A5 of 2007	21/03/07	Regulations 4.16 and 4.17
A6 of 2007	11/04/07	Subsection 93(4)
A7 of 2007	20/04/07	Regulation 9.03D(3)
A8 of 2007	20/04/07	Regulation 9.04D(3)
A9 of 2007	01/05/07	Subsection 89(3)(c)
A10 of 2007	27/04/07	Regulation 9.04D(1)
A11 of 2007	29/05/07	Regulation 9.04D(1)

Modification declaration number	Date	Provision of SIS regulations modified
Class		
1 of 2007	28/06/07	Regulation 4.16

Commonwealth Authorities and Companies Act 1997 (CAC Act)

Auditor-General's activities

APRA was not subject to any performance audits by the Australian National Audit Office (ANAO) in 2006/07. The ANAO outlined APRA's supervision of superannuation funds in its *Report on the Australian Taxation Office's Approach to Regulating and Registering Self Managed Superannuation Funds*, tabled in June 2007. APRA contributed to the ANAO's *Better Practice Guide on Administering Regulation*, issued in March 2007.

Executive Group attendance

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

Executive Group qualifications

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

Statement by Members

See page 74 of the *Financial statements* in this Report.

Courts and tribunals

Over 2006/07, a number of judicial and Administrative Appeals Tribunal (AAT) decisions had, or may have, a significant effect on APRA's operations. These involved:

- *VBN & Ors*, in which the AAT set aside APRA's decision to disqualify seven directors of the former trustee of the AXA Australia Staff Superannuation Plan;
- *X & Ors v APRA*, in which the High Court of Australia ruled that the use of evidence obtained from individuals in a Royal Commission for disqualification purposes under the *Insurance Act 1973* against those individuals was not prohibited by the provisions of the *Royal Commissions Act 1902*;
- *Kamha v APRA*, in which the High Court of Australia refused an application for leave to appeal the decision of the Full Bench of the Federal Court in *Kamha v APRA*; and
- *APRA v Cameron*, in which APRA successfully applied to the Federal Court for Orders restraining certain individuals from conducting unauthorised banking business and issuing notes for payment in contravention of the *Reserve Bank Act 1959*.

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

Enabling legislation and information on purpose and functions

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

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

Following the enactment of the *Governance Review Implementation (Treasury Portfolio Agencies) Act 2007*, APRA's financial arrangements have, from 1 July 2007, been subject to the *Financial Management and Accountability Act 1997* (FMA Act).

Commonwealth Ombudsman

The Commonwealth Ombudsman conducted investigations into seven matters, of which six related to early release of superannuation benefits. There was no negative comment about APRA's activities.

Financial statements

See page 76 of this Report.

Indemnities and insurance premiums

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

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

Location

See page 138 of this Report.

Organisation chart

See pages 134-135 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 2006/07, APRA Members and officers made themselves available for public hearings before the Senate Economics Legislation Committee (sitting as Senate Estimates) on 2 November 2006 and on 15 February and 29 May 2007, and before the Parliamentary Joint Committee on Corporations and Financial Services in its Inquiry into the Structure and Operation of the Superannuation Industry on 7 March 2007.

Privacy Commission

There were no investigations by the Privacy Commissioner under section 36 of the *Privacy Act 1988* during 2006/07. 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 Commissioner in respect of APRA's operations.

Privacy inquiries relating to APRA should be addressed to:

The Privacy Officer
Legal Services
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001

Phone: 02 9210 3000
Fax: 02 9210 3424

Responsible Ministers

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

He is assisted in this by the Minister for Revenue and Assistant Treasurer, the Hon Peter Dutton MP.

Review of operations and prospects

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

Risk Management and Audit Committee attendance

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

Statement on governance

See the *Governance* section of this Report.

Environment Protection and Biodiversity Conservation Act 1999

Ecologically sustainable development and environmental performance

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

APRA's Environmental Policy Statement reinforces its commitment to managing environmental matters through its Green Taskforce and to the implementation of an Environmental Management System.

In the *Energy Use in the Australian Government's Operations - Report for 2005-2006,* the Australian Greenhouse Office showed that overall energy consumption per person in APRA offices was 9,370 MJ, which was well below the target of 10,000 MJ/person.

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

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

Workplace diversity program report

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

In 2006/07, APRA's Workplace Diversity Taskforce recommended a number of initiatives to enable APRA to make best use of its highly diverse workforce. These included the establishment of a parent's room, reserved places in a CBD childcare centre, a 'Transition to Retirement' program and a range of health and well-being programs. A number of these initiatives have been implemented and others will be further developed over the next 12 months. As a result of its initiatives, APRA was ranked 17 out of 282 participating public and private organisations in a national work/life benchmarking study.

EEO staff data – staff diversity as at 30 June 2007

Level	Female	Male	ATSI	NESB1	NESB2	PWD
Level 1	56	19	0	16	1	1
Level 2	68	47	0	22	6	0
Level 3	78	80	1	47	7	0
Level 4	51	96	0	35	1	1
Senior	8	51	0	12	2	1
Executive	3	25	0	1	0	0
Total	**264**	**318**	**1**	**133**	**17**	**3**

ATSI Aboriginal and Torres Strait Islander

NESB1 Non-English-speaking background, first generation

NESB2 Non-English-speaking background, second generation

PWD People with disability

Freedom of Information Act 1982 (FOI Act)

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

In 2006/07, APRA received 10 applications under the FOI Act, including one application for internal review.

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

Granted in full	0
Granted in part	2
Access refused	3
Withdrawn	2
Transferred to another agency	0
On hand at 30 June 2006	3
Total	**10**

Charges collected were $430.00 and the estimated cost of handling FOI requests in 2006/07 was $7,500.

Initial contact for requests under FOI Act

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

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

Access to documents

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

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

Questions about publications should be made to:

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

Categories of documents

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

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

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

Details of investigations and other matters as prescribed

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

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

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

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

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

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

APRA's policy and procedures are maintained with the assistance of a consultant ergonomic specialist to identify, assess and control hazards associated with work processes, particularly computer-based work. Sessions informing staff of the ideal ergonomic set-up for their individual workstations were held in Sydney, Brisbane and Canberra in late 2006 with additional sessions in Sydney in May 2007. Several sessions were also held in Sydney in 2006 to help staff better prepare for lunch-time sporting activities in an effort to avoid injuries; following these sessions, the number of workers compensation claims related to lunch-time sports injuries reduced considerably.

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.

APRA's intranet has been refreshed with new and updated information on occupational health and safety issues, and a new and improved health and well-being program has been introduced. In 2007, full health assessments (previously only available to senior staff) were also made available to staff over 50 years of age. Mini-health assessments were also offered to all staff between Levels 1 and 4 under the age of 50. The assessments are intended to be an annual event managed along the same lines as APRA's influenza vaccination program.

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

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

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

Statistics requiring the giving of notice under section 68

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

Location	Number
On APRA premises	1
Home to work/work to home	3
Other	2
Total	**6**

Other reporting

Commonwealth Disability Strategy

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

Commonwealth Fraud Control Guidelines

Fraud control

The Chairman of APRA certifies that he is satisfied that:

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

Consultancies

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

The main purposes for which consultants were engaged in 2006/07 were audit services; training; financial and accounting services; IT consultancies; legal advice; litigation services; recruitment selection, administration and counselling; and professional services.

In 2006/07, the total number of consultants engaged was 89 and the total amount paid was $3.79 million.

Consultative arrangements

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

Executive and consultative committees from 1 July 2006 to 30 June 2007

Management Group

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

Leadership Team

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

Steering Groups

To strengthen APRA's efficiency and effectiveness and improve staff motivation and retention, the APRA Members established three new Steering Groups in 2006/07 to implement a range of initiatives. These Groups comprise an APRA Member as Chair and relevant Executive General Managers and General Managers. The Groups are:

- *Supervision Steering Group*. This Group oversees the development and integration of APRA's supervisory systems, tools and processes.
- *Infrastructure Steering Group.* This Group oversees the development of APRA's physical and IT infrastructure and its business, financial and resource planning systems.
- *People and Engagement Steering Group*. This Group addresses initiatives on management and leadership, performance management, rewards and recognitions, and APRA culture.

Industry groups

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

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

These groups are a key forum for identifying 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 different industry sectors, prior to presentation of these issues to the Executive Group.

Basel II Steering Group

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

Cross-Divisional Licensing Committee

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

Occupational Health and Safety Committee

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

Staff Consultative Group

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

Performance pay

APRA has a performance bonus system, designed in consultation with staff and management and covering all employees. For 2006/07, the aggregate bonus pool was $3 million. Bonuses were paid in late July 2007.

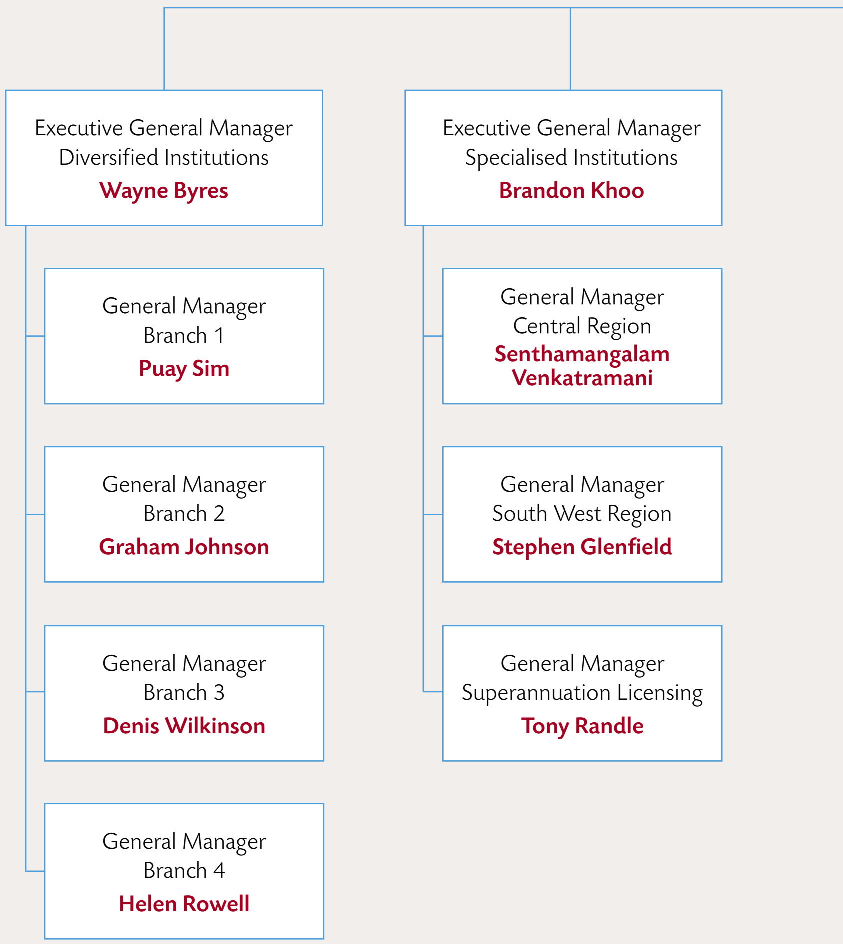
Staff statistics

Staff by location and full-time/part-time as at 30 June 2007

Location	Full-time	Part-time	Total
Adelaide	7	0	7
Brisbane	14	2	16
Canberra	27	19	46
Melbourne	65	3	68
Perth	7	0	7
Sydney	425	13	438
Total	**545**	**37**	**582**

Staff by division and full-time/part-time as at 30 June 2007

Division	Full-time	Part-time	Total
Corporate	109	23	132
Diversified Institutions	99	2	101
Policy, Research and Statistics	75	3	78
Specialised Institutions	125	5	130
Supervisory Support	137	4	141
Total	**545**	**37**	**582**


Executive General Manager
Diversified Institutions
Wayne Byres
General Manager
Branch 1
Puay Sim
General Manager
Branch 2
Graham Johnson
General Manager
Branch 3
Denis Wilkinson
General Manager
Branch 4
Helen Rowell
Executive General Manager
Specialised Institutions
Brandon Khoo
General Manager
Central Region
Senthamangalam Venkatramani
General Manager
South West Region
Stephen Glenfield
General Manager
Superannuation Licensing
Tony Randle

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

Risk Management and Audit Committee

Executive General Manager Supervisory Support
Tom Karp

- General Manager Industry Technical Services — **Heidi Richards**
- General Manager AMIRS[1] — **David Rush**
- General Manager CORS[2] — **Harvey Crapp**
- General Counsel Legal Services — **Patrick Meaney**
- General Manager Enforcement — **Roger Brown**
- General Manager VIP Support[3] — **David Lewis**

Executive General Manager Policy, Research and Statistics
Charles Littrell

- General Manager Policy Development — **Keith Chapman**
- Program Director Basel II — **Bernie Egan**
- General Manager Statistics — **Steve Davies**

Secretary — **Thea Rosenbaum**

Chief Financial Officer — **Jim Flaye**

General Manager Human Resources — **Peter Vodicka**

General Manager Business Services — **Colin Cayless**

General Manager Risk Assessment and Internal Audit — **Paul Thompson**

Head of Public Affairs — **Stuart Snell**

[1] AMIRS – Actuarial Market and Insurance Risk Services
[2] CORS – Credit and Operational Risk Services
[3] VIP – Value and Investing in our People

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

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

Info line: 1300 131 060

Website: www.apra.gov.au

Email: contactapra@apra.gov.au

Head office

New South Wales

Delivery address:

APRA
Level 26
400 George Street
SYDNEY NSW 2000

Mailing address:

GPO Box 9836
SYDNEY NSW 2001

Phone: 02 9210 3000
Fax: 02 9210 3411

Other offices

Australian Capital Territory

Delivery address:

APRA
Level 2
243–251 Northbourne Avenue
LYNEHAM ACT 2602

Mailing address:

GPO Box 9836
CANBERRA ACT 2601

Phone: 1300 131 060
Fax: 02 6213 5307

Queensland

Delivery address:

APRA
Level 23
300 Queen Street
BRISBANE QLD 4000

Mailing address:

GPO Box 9836
BRISBANE QLD 4001

Phone: 07 3001 8500
Fax: 07 3001 8501

South Australia

Delivery address:

APRA
Level 5
100 Pirie Street
ADELAIDE SA 5000

Mailing address:

GPO Box 9836
ADELAIDE SA 5001

Phone: 08 8235 3200
Fax: 08 8232 5180

Victoria

Delivery address:

APRA
Level 21, Casselden Place
2 Lonsdale Street
MELBOURNE VIC 3000

Mailing address:

GPO Box 9836
MELBOURNE VIC 3001

Phone: 03 9246 7500
Fax: 03 9663 5085

Western Australia

Delivery address:

APRA
Level 9, QV.1 Building
250 St Georges Terrace
PERTH WA 6000

Mailing address:

GPO Box 9836
PERTH WA 6001

Phone: 08 9481 8266
Fax: 08 9481 8142