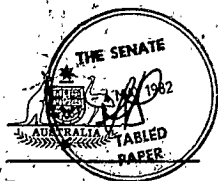


Government Aircraft Factories



Report

198

Joint Committee of
Public Accounts

DEPARTMENT OF THE SENATE	
PAPER No.	882
DATE PRESENTED	4 MAY 1982
<i>W. Macdonald</i> Clerk of the Senate	

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

JOINT COMMITTEE OF PUBLIC ACCOUNTS

198th REPORT

DEPARTMENT OF INDUSTRY AND COMMERCE

GOVERNMENT AIRCRAFT FACTORIES

Australian Government Publishing Service
CANBERRA 1982

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DUTIES OF THE COMMITTEE

Section 8.(1) of the Public Accounts Committee Act 1951 reads as follows:

8.(1) Subject to sub-section (2), the duties of the Committee are:

- (a) to examine the accounts of the receipts and expenditure of the Commonwealth including the *financial statements* transmitted to the Auditor-General under sub-section (4) of section 50 of the Audit Act 1901;
- (aa) to examine the financial affairs of authorities of the Commonwealth to which this Act applies and of intergovernmental bodies to which this Act applies;
- (ab) to examine all reports of the Auditor-General (including reports of the results of efficiency audits) copies of which have been laid before the Houses of the Parliament;
- (b) to report to both Houses of the Parliament, with such comment as it thinks fit, any items or matters in those accounts, statements and reports, or any circumstances connected with them, to which the Committee is of the opinion that the attention of the Parliament should be directed;
- (c) to report to both Houses of the Parliament any alteration which the Committee thinks desirable in the form of the public accounts or in the method of keeping them, or in the mode of receipt, control, issue or payment of public moneys; and
- (d) to inquire into any question in connexion with the public accounts which is referred to it by either House of the Parliament, and to report to that House upon that question,

and include such other duties as are assigned to the Committee by Joint Standing Orders approved by both Houses of the Parliament.

PREFACE

This Report on the administration of the Government Aircraft Factories arose out of unfavourable comments of the Auditor-General in his Report for the year ended 30 June 1980.

Following examination of submissions from the Department of Industry and Commerce, the Committee took evidence at Public Hearings on 26 May 1981 and 2 June 1981. This was supplemented by an inspection of the Government Aircraft Factories' facilities at Fishermen's Bend and Avalon on 4 August 1981 and visits to and discussions with the Commonwealth Aircraft Corporation at Fishermen's Bend, Victoria and Hawker de Havilland Pty Ltd at Bankstown N.S.W.

Attention in this inquiry focused on three main areas:

- . Issues raised by the Auditor-General.
- . Efficiency of the management of the factories including level of support received from the Department of Industry and Commerce in Canberra.
- . Issues arising from the inquiry including the future of the Maintenance of Production Capability appropriation and the current structure of the aircraft industry.

During this inquiry, the Committee experienced considerable delay on the part of the Department of Industry and Commerce in the provision of information requested during the public hearings. The Committee would remind all Departments of the Committee's requirement for all information which may be requested to be provided in a timely and efficient manner.

For and on behalf of the Committee,

David M. Connolly, MP
Chairman

M.J. Talberg
Secretary
Joint Committee of Public Accounts
Parliament House
Canberra
9 March 1982

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DEPARTMENT OF INDUSTRY AND COMMERCE

GOVERNMENT AIRCRAFT FACTORIES

CHAPTER 1

Introduction

1.1 Since the early 1970's the Government Aircraft Factories (GAF) have come under repeated adverse criticism from the Auditor-General with regard to accounting, financial control and management procedures followed at the factories. Since his 1977/78 Report, criticism of GAF has become more detailed and specific in nature primarily because of the recently adopted practice of GAF submitting detailed financial statements to the Auditor-General for audit. In paragraph 2.18.2 of his report of 1978/79, the Auditor-General stated, inter alia that:

"... collectively the unsatisfactory accounting disclosed by Audit represented a critical state of affairs."

The results of the extensive audits, particularly over the last 2 years, confirm the need for a prompt and thorough revision of the accounting and related management and control systems at GAF with positive early action by management to effect control measures." (PAC emphasis)

1.2 The Committee has for some time been seriously concerned about the continuing inability of GAF to rectify problems in their basic accounting procedures.

1.3 The aim of this inquiry was to examine the more serious observations of the Auditor-General identified in his 1979/80 Report, and then to examine in some detail the management operation of the Factories in an attempt to identify the reasons and suggest possible solutions to the continuing problems found at GAF.

1.4 In his Report for 1979/80 the Auditor-General again drew the Parliament's attention to continuing problems in accounting procedure and practice at the Government Aircraft Factories (GAF) in Melbourne. The criticism related largely to the inability of the Auditor-General to express an opinion on whether the financial statements show fairly the financial transactions for the year and state of affairs of the factory at balance date, to accord with the recommendations in the 34th Report of the Joint Committee of Public Accounts ("The Trust Fund") and to comply with the provisions of Section 41D of the Audit Act which states:

41D.(1) A Department, being a Department of State of the Commonwealth, shall, if so required by the Minister keep such accounts and prepare such financial statements in respect of such of its operations, and in such form, as the Minister determines.

(2) Accounts kept and statements prepared under this section and all records relating to those accounts and statements shall be subject to inspection, examination and audit by the Auditor-General.

(3) The provisions of this section shall be read as in addition to and not in derogation from the other provisions of this Act.

Major impediments to the issue of an unqualified certificate on the Financial Statements of the Factories were identified as:

- . prescribed reconciliations of certain control ledger accounts were not effected;
- . a significant proportion of issue vouchers for materials issued to production were not brought to account;
- . procedures for control of goods despatch advices were defective and a relatively large number of these documents were not accounted for;
- . administration expenses included in notional costs were calculated on the basis of a rate derived from a survey of administration costs in selected departments during the year ended 30 May 1976;
- . not all accruals relating to sales, debtors, creditors and costs of production were brought to account;
- . work-in-progress (WIP) and stores are not valued at the lower of cost or net realisable value. WIP includes profits and losses on various orders and stores stock includes obsolete and surplus items;
- . repairs and maintenance funded by the Department of Housing and Construction included as notional operating costs are based on the financial year ended 30 June 1979 instead of the Factories' balance date; and
- . the approved depreciation charge in respect of plant and machinery was calculated as a percentage of the total historical cost without sufficient reference to

the potential technical life of individual assets or groups of assets.

In addition, the Auditor-General identified the following items of accounting principle and procedures as unsatisfactory:

- . Reconciliation of control ledger accounts with subsidiary records;
- . unexplained discrepancies of \$32,242 within a balance of \$1,762,317 in the reconciliation of the Factories Trust Account with the Department of Finance Ledger system;
- . failure to issue promptly taxation group certificates to former employees;
- . controls over the Register of Unclaimed Wages to prevent manipulation;
- . absence of proper delegations to engage or discharge employees and approve overtime;
- . security of payroll during distribution;
- . the need for regular checks upon leave records and paysheets;
- . review of excessive recreation leave credits;
- . the need for regular medical reviews of compensation cases when the person concerned continues in employment;
- . the reserve capacity cost subsidy had been claimed in advance of entitlement in several instances; and
- . profits and losses on operations had not been debited or credited to the Reserve Capacity Maintenance appropriation within a reasonable time after the accounting period had ended.

1.5 There was some duplication of items in each of these categories.

1.6 In accord with normal practice, the Committee received a written response from the Department of Industry and Commerce addressing the matters raised by the Auditor-General. It revealed that a number of the issues had been successfully resolved. However, many major matters were still outstanding. Below are the findings of the Committee and our related recommendations.

CHAPTER 2

THE AIRCRAFT INDUSTRY IN AUSTRALIA - AN OVERVIEW

Historical Perspective and Structure

2.1 Apart from a small number of locally designed and built aircraft, local manufacture of aircraft in Australia was not commenced until World War II. It reached its peak during 1942-45 building fighters, bombers and training aircraft of both overseas and local design.

2.2 The Australian aircraft industry consists primarily of three major organisations concerned with production and maintenance activities associated principally with military aircraft. These organisations are:

- The Government Aircraft Factory (GAF), established in 1939 (see below).
- The Commonwealth Aircraft Corporation (C.A.C.) was established in 1936. It is a consortium of Australian and British companies including B.H.P. Nominees Pty. Ltd., North Broken Hill Holdings Ltd., B.H. South Ltd., Rolls-Royce Ltd., P&O Australia Holdings Pty. Ltd. and I.C.I. Australia Investments Pty. Ltd.
- Hawker de Havilland (HDH) is the wholly owned Australian subsidiary of the Hawker Siddeley Co. of Britain, established in 1927.

2.3 The three organisations make use of a wide range of sub-contractors. The 1975 Industries Assistance Commission Report into the Aerospace Industry¹ indicates that there are some 30 private organisations of this type including Amalgamated Wireless (Australia) Limited, E.M.I. Electronics (Australia) Pty. Limited, Australian National Industries Limited and Dunlop Australia Limited. It is clear however that the work of these organisations generally constitutes only a minor part of each firm's overall activities.

2.4 Research and General Support facilities are provided by the Aeronautical Research Laboratories (ARL), Weapons Research Establishment (WRE) and a number of other government factories. In addition, there are a number of airlines, including Qantas, that repair and modify civil and military aircraft engines.

1 Australia, Parliament, Aerospace Industry - Industries Assistance Commission Report, 21 October 1975. Parliamentary Paper No. 39/1976, Canberra 1976.

Employment

2.5 As at 30 June 1981 employment in the three major manufacturers was 6112 broken down as follows:¹

C.A.C.	-	1882
G.A.F.	-	2466
H.D.H.	-	1774

2.6 Regarding skills retained within the industry, the 1975 IAC report stated that:

"Aerospace manufacturing tasks call for a high proportion of skilled labour. This includes designers, engineers, draftsmen and technical officers as well as sheet metal workers, tool makers, machinists, fitters, welders and electricians.

Some skills are so specialised to aerospace work that they are not readily transferable to other industries. This applies particularly to many of the technical and professional skills involved in design and engineering. In general, skilled tradesmen would have little difficulty in finding employment in other sections of manufacturing industry, although some retraining may be required where trade qualifications are not interchangeable.

In some instances, the skills involved are unique to aerospace work and unless they are practised regularly cannot be maintained."

Government Involvement in The Industry

2.7 The involvement of the Government in the aircraft industry is substantial, mainly because the industry exists primarily for and is heavily dependant on defence work. Apart from owning G.A.F., it has agreements with private companies which establish the bases under which they undertake work for the Commonwealth and make use of government provided assets.

2.8 The government owns a significant proportion of the combined assets of CAC, HDH and GAF in land, buildings, plant and equipment and it continues to provide to the private firms those assets necessary for defence work.

1 Committee File 1980/9, Auditor-General's Report 1979/80 Part B(6). H.D.H. includes 50 employees at De Havilland Marine at Homebush Bay in New South Wales which manufactures various types of small and medium boats.

2.9 The Government also provides capital for the continuance of the aerospace industry through the provision of funds through the "Maintenance of Production Capability" (RCM) vote (Division 385).¹

2.10 The purpose of the Maintenance of Production Capability appropriation, which has existed since 1945-46, is to meet various costs which are incurred in maintaining production capability in defence factories for emergency defence needs but which are not covered by receipts arising from current use of that capability. Simply, the appropriation for RCM is provided to compensate for the costs which cannot be absorbed for a variety of reasons in prices charged to customers. The amount of appropriation required is influenced to a large degree by:

- the level of overheads to be carried as a result of defence related capabilities;
- the workload levels expressed in forecast production hours, ie the extent to which they fall short of installed capability;
- the workload mix - rates at which customers are charged for work varies between classes of customers. Commercial customers are charged at higher rates than Department of Defence and therefore contribute more to overheads; and
- different overhead costs between factories owing to the differing natures of the products and the indirect support required.

2.11 In 1980-81, expenditure for RCM in the aerospace industry was \$22,517,152 broken down as follows:

GAF	\$12,722,632
CAC Ltd	4,731,220
HDH Pty Ltd	5,063,300
	<u>\$22,517,152</u>

Details of the background and administration of this appropriation are attached at Annex A.2

1 1981-82 Budget Paper No. 2, Appropriation Bill (No. 1), AGPS Canberra 1981, p. 89.
2 Public Accounts Committee File 1980/9, op. cit.

CHAPTER 3

GOVERNMENT AIRCRAFT FACTORIES

Background

3.1 GAF was established by the Australian Government in 1939 for the purpose of manufacturing the Beaufort Torpedo Bomber Aircraft. The Factories are administered by the Aircraft, Guided Weapons and Electronic System (AGWES) division of the Department of Industry and Commerce. The prime objective of the AGWES division is to develop and maintain an Australian defence aerospace industry with the maximum achievable capability for support of the defence force requirements in peace and war. In support of the AGWES objective, GAF is responsible for the design, development, production and marketing of aerospace products and associated equipments. The Factories also provide services to meet defence requirements and undertake such other approved Government and civil projects as will contribute to the maintenance of capability and capacity and the retention of skills. The functions of the Factories include:

- design, develop, produce and market aircraft, guided weapons and other aerospace products for local or overseas markets, including spares and options and after- sales support;
- develop, produce and install modifications and repair schemes for service aircraft and guided weapons;
- develop, produce and instal modifications and repair schemes for civil aircraft of factory origin;
- provide technical support services to the operators of factory products;
- provide repair and maintenance services for service aircraft;
- produce aerospace components arising from Government offset agreements and invitations from overseas principals; and
- market special skills and capabilities otherwise acquired or developed for aerospace requirements.

Major items of GAF design include:

- Jindivic Sub-sonic Target Drone;
- Malkara Surface to Surface Anti-Tank Guided Weapon;

- Ikara Shipborne Anti-Submarine Guided Weapon;
- Turana Target Drone; and
- Nomad Aircraft

3.2 At the end of the 1979/80 financial year employment at GAF was 2,430 and the turnover for that year was around \$45 million.

3.3 Administratively, the GAF organisation structure is comprised of five sections responsible to the General Manager.

3.4 Within the AGWES organisation the General Manager GAF is responsible for the efficient, safe and economical operations of the factories. A chart of the GAF organisation, together with functional statements of the five sections, is attached at Annex B.

3.5 The factories operate at two locations, Fishermen's Bend and Avalon. Fabrication of detail parts and major component assembly is undertaken at the Fishermen's Bend plant whilst a limited amount of aircraft fabrication, aircraft final assembly, servicing and flight tests are conducted at Avalon.

Financial Statements

3.6 GAF is responsible for producing two types of financial statements on its operation. There is a statutory obligation for the General Manager of GAF under the Supply and Development Act 1939 (Regulation 44, of Statutory Rule No. 59 of 1949) to:

"before the thirtieth day of September of each year, submit to the Board or the Administrator, as the case may be, a report on the working of the undertaking or undertakings under his charge, together with a statement of accounts and balance-sheet."

These annual financial statements are prepared and presented to the Production Board but are not certified by the Auditor-General. The operating statements bring to account transactions through the Factory Trust Account only, thus excluding non-cash costs such as superannuation, interest on capital and support services provided free of charge by other Government instrumentalities such as the Department of Housing and Construction, Department of Health etc. The balance sheet records capital items such as Plant and Machinery provided by appropriations.

3.7 Since 1978/79 GAF has been required under Section 41D of the Audit Act to submit to the Auditor-General a Memorandum Trading Statement and a Memorandum of Assets and Liabilities

for each financial year. These are essentially the same as the balance sheets submitted to the Production Board, but include estimates of notional costs for operation of the factories.

3.8 In June 1969, following a re-examination of the financial statements of Government Factories, the Auditor-General's office informed the Treasury that the memoranda financial statements did not appear to meet the qualifying conditions suggested in paragraph 162 of the 34th Report of this Committee, particularly those in sub-paragraph (ii) and (iii). Therefore, in December 1970 the Treasurer directed the Treasury to convene a Working Party, comprising representatives of the Treasury, Supply, the Auditor-General's Office and Defence to prepare a report aimed at recommending measures to overcome deficiencies in the accounting arrangements and financial statements which had been referred to by the Joint Committee of Public Accounts and the Auditor-General over previous years.

3.9 The first interim report of the Working Party of September 1971 foreshadowed the need for financial statements to be prepared by Government Factories containing a record of all costs and all income so as to accurately reflect the true annual cost of their operation. It was resolved that the aim should be to have a form of financial statements which would be useful and meaningful in the area of management decisions and for the information of members of Parliament.

3.10 In September 1974 a draft form of financial statements comprising a Statement of Assets and Liabilities and a Memorandum Trading Statement was presented as part of the second interim report of the Working Party. Subject to minor amendment, this form of accounts was subsequently recommended and accepted as part of the final report of the working party which was presented in November 1976.

3.11 The Trading Statements make provision for the inclusion of all costs, the omission of which had been criticised by the Auditor-General. The notes to the statement provide the break-up of overheads into amounts charged to current production and the reserve capacity appropriation; an analysis of variances; any profit or loss made (based on prices charged and costs allocated under the adopted costing

- 1 Australia, Parliament, Joint Committee of Public Accounts, 34th Report, The Trust Fund, Parliamentary Paper 69/1957. AGPS, Canberra 1957, p. 39.
- 2 Joint Committee of Public Accounts, Auditor-General's Report 1979/80. Government Aircraft Factories, Minutes of Evidence, AGPS, Canberra 1982, p. 313.
- 3 Ibid. p. 366.

system); and explanations of items such as depreciation and interest which are shown as notional expenses - matched by notional income. It should be noted however that at the time of preparation of the Auditor-General's report, his Office indicated that while it was in agreement with the form and content of the Statement of Assets and Liabilities, and Memorandum Trading Statement adequately supported by notes attached thereto, one possible area of difficulty would be the assessment of the accuracy of support (notional) costs and that this would probably involve in-depth examination of the calculation bases used by departments. (A copy of the final report of the working party along with a copy of the approved forms of accounts are attached at Annex C and D respectively.)

3.12 G.A.F. first submitted the new prescribed form of accounts, for the financial year 1978-79. The 1979-80 set was, at the time of inquiry, in the process of Audit examination.

Parliamentary Scrutiny

3.13 The major issue apparent from our examination of the financial reporting arrangements for G.A.F. is the absolute lack of the opportunity for the Parliament to scrutinise the financial achievement of GAF or any other Government factories, outside the Committee system. Whilst recognising that this issue is not confined to the Factories, or indeed to the Department of Industry and Commerce, this is cause for some concern to the Committee.

3.14 The two lines of financial reporting observed at GAF being the annual report of the General Manager to the Production Board and the Memorandum Trading Statement and Memorandum of Assets and Liabilities do not receive the scrutiny of Parliament. The General Manager's annual report, including summarised balance sheets are presented to the Production Board of the Department of Industry and Commerce which may then pass them on to the Minister with any comments it wishes to add.¹ The Financial Statements presented to the Auditor-General, following examination are sent to the Permanent Head of the Department and a copy is sent back to G.A.F.

3.15 The Committee was concerned that it could find no evidence of anything more than the most rudimentary information on the financial affairs of GAF which had been presented to Parliament, particularly since the Working Party

mentioned above stated that it saw no impediment to the Memorandum Trading Statement and the Memorandum of Assets and Liabilities being tabled in Parliament in accordance with paragraph 162.(v) of our 34th Report.¹

Observations of the Auditor-General

3.16 Notional costs are those costs which are not actually incurred by G.A.F. but represent a charge on the Commonwealth for the operation of the factories. These may include such items as the provision of one doctor and three nurses to the factories the cost of which is borne by the Department of Health; the maintenance of the factory buildings which is a cost to the Department of Housing and Construction; Commonwealth contribution to the employees superannuation fund; cost of Head Office support, which is a cost to the Department of Industry and Commerce.²

3.17 The Committee was informed that those notional costs are not a part of the factories' costs in any way. The only time that they appear are as an entry in the Memorandum Trading Statement and the Memorandum of Assets and Liabilities for each financial year which are presented to the Auditor-General.³ As mentioned above, this was one of the prime recommendations of the Working Party on accounting in Government Factories (See Annex C and D). The day to day operations of the factories are controlled through the trust account which is the equivalent of a cash account in a normal accounting system.⁴ The trust account does not include provision for notional entries.

3.18 The Committee expressed concern that while G.A.F. was not itself paying for some of the services provided at the factories; such as maintenance and the provision of medical services; this was nevertheless a cost to the Commonwealth that was not being reflected in the prices charged by the Factory for their product. The Department stated that this was indeed the case for work done for the Department of Defence but that in relation to the costing of work done for commercial customers, excluding work on the Nomad, costs are allowed for those heads of expenditure.⁵ Funds received by the factories from commercial work under notional heads of expenditure are, where a profit is achieved on the order, credited direct to the Factories Trust Account. In the case of the Nomad, special arrangements have been formalised with the Department of Finance where funds are paid into consolidated revenue.

1 Minutes of Evidence, op. cit., pp. 340-341.

2 Ibid., p. 342.

3 Ibid., p. 243.

4 Ibid., p. 243.

1 Minutes of Evidence, op. cit., p. 347

2 Ibid., p. 233.

3 Ibid., p. 240.

4 Ibid., p. 241.

5 Ibid., p. 237.

3.19 In his report for 1979/80, the Auditor-General noted two problem areas in G.A.F.'s handling of notional costing. Firstly, it was reported that administration expenses in notional costs were calculated on the basis of a rate derived from a survey of administrative costs in selected departments during the year ended 30 May, 1976. Secondly, repairs and maintenance funded by the Department of Housing and Construction included as notional operating costs are based on the financial year ended 30 June, rather than the factories balance date of 27 May.¹

3.20 In relation to the first query, the Department claimed that the working party which conducted the 1976 survey recommended that a review of the charge was only necessary every three years. The three years used in the first instance includes 1978/79, the year to which the Auditor-General's comments relate. In addition, the Department claimed that in view of the three year limitation, they referred the matter to the Department of Finance concerning the need to reassess the figures for 1979/80 and was advised that there was no need to review the figures until a review of further experience with the operation of the format of the Memorandum Trading Statement and the Memorandum of Assets and Liabilities was finalised. In the light of this, G.A.F. was instructed to apply a percentage of total operating costs to cover this charge. Therefore, while the percentage was based on the 1976 figures, the actual charge in the 1978/79 financial statements was upgraded in line with current costs.²

3.21 Regarding the second query, the Department in its submission points out that the Auditor-General's office was advised before the Financial Statements were finalised that the Department of Housing and Construction was not able to supply the figures for the factory financial year. Both the Auditor-General's Office and Department of Finance agreed it would be acceptable to use the figures to 30 June. A notation was included on the Financial Statements to the effect that the period covered by the figures was 1/7/78 to 30/6/79. The Department of Housing and Construction was subsequently requested to make the necessary arrangements to supply the figures for 1979/80 to accord with the factory financial year and they have complied.³

Valuation of Work In Progress and Stores

3.22 The Auditor-General noted that at G.A.F., Work In Progress (WIP) and stores were not valued at the lower of cost or net realisable value as would be normal accounting practice

and that WIP includes profits and losses on various orders and stores stock includes obsolete and surplus items.

3.23 In reply, the Department stated that WIP at GAF is valued at selling prices and stores stock at cost in accordance with Departmental accounting manuals. In addition, the Department claimed that a review of the bases of valuing WIP and stores stock will be conducted this year to assess the merits of alternate bases of valuation.¹

3.24 When questioned by the Committee on this issue the Department acknowledged that in the strict accounting sense, stock and work in progress should be valued at the least of a number of alternatives. In the case of WIP at G.A.F. when a pricing loss is made, an estimate of the actual cost of the item is made. When authority is given to quote a sale price, which is lower than the actual cost, the difference is taken up in WIP over a period of time. That is, the value of WIP is reduced over time to the least of cost or realisable value in that particular situation.²

3.25 Regarding the valuation of stores, the Department claimed that they are valued on the basis of what it cost, irrespective of what its realisable value is. This is primarily because of the difficulty of determining the actual realisable value without selling the goods. The Department does however intend to undertake a review of the basis of valuing WIP and stores stock to assess the merits of alternate bases of valuation.

Depreciation Charges

3.26 The Auditor-General reported that at G.A.F. the approved depreciation charge in respect of plant and machinery was calculated as a percentage of the total historical cost without sufficient reference to the potential technical life of individual assets or groups of assets.

3.27 The Department advised that in view of Audit's dissatisfaction with the current system, various systems were considered and a submission was made to the Department of Finance in November 1979 concerning a system based on the potential life of specified categories of plant. It emerged that no change would be made in the basis of depreciating plant pending a joint assessment of matters arising out of the audit reports on the factories.³

1 Report of the Auditor-General for year ended 30 June 1980. AGPS Canberra, p. 112, para. 2-19-2.
2 Minutes of Evidence, op. cit. pp. 217-218.
3 Ibid., p. 218.

1 Minutes of Evidence, op. cit., pp. 218 and 280.
2 Ibid., p. 280.
3 Ibid., p. 218.

Reconciliation of Control Ledger Accounts with Subsidiary Records

3.28 As part of the audit of the Factories' financial statements for 1978-79, a review was conducted of reconciliations required to be performed each accounting period in accordance with factory financial procedures. The review disclosed an unsatisfactory position. The Auditor-General advised GAF in September 1979 that of some thirty control accounts involved, ten had not been reconciled during the year and six had been reconciled at other than the prescribed intervals. The reconciliation of the Factories' Trust Account with the Department of Finance Ledger system also revealed unexplained discrepancies totalling \$32,242 within a balance of \$1,762,317 as at 27 May 1979. The Auditor-General noted that since the same transactions are required to be posted in both the Department of Finance system and the factory subsidiary ledger, it is a matter of concern that such discrepancies arise.

3.29 The reconciliations mentioned by the Auditor-General related to the Factories' control account and the subsidiary accounts and that failure to reconcile these accounts on a regular and timely basis would result in the control account not necessarily reflecting the true position of the Factories' financial operations.¹ In its submission to the Committee, the Department stated that all control ledger accounts have been investigated and reconciled and the frequency of reconciliation has improved although not all reconciliations are being effected at the programmed intervals, primarily each month.

3.30 The Department claimed that at the end of the GAF 1979/80 financial year (27 May 1980), all accounts were reconciled to ensure the financial statement for 1979/80 reflected the true situation. Also, the Department claims to have formalised a statement reporting to higher levels of management that the reconciliations have been undertaken.²

3.31 The Committee is particularly concerned that such an important mechanism in the financial control of GAF was allowed to fall into such a state of disarray. The Departmental Accounting Manual clearly lays down the requirement for regular periodic reconciliation of control accounts at GAF in Section 2, paragraphs 10.4.10 to 10.4.15.

3.32 The Committee feels that this issue highlights an unacceptable level of lack of insistence on control in the

1 Auditor-General's Report 1979/80, op. cit., p. 110 para 2.19.2.

2 Minutes of Evidence, op. cit., p. 219.

3 Ibid., pp. 228 and 212.

finance area of GAF. The Committee is however heartened to observe that some effort is now being made to reconcile these accounts regularly and to introduce a reporting mechanism to ensure that this is being done. The impact of this action will be closely monitored by the Committee in future Reports of the Auditor-General.

3.33 The paucity of financial control at GAF was further highlighted through the issue of the unexplained discrepancy of \$32,242 in the reconciliation of the Factories' Trust Account and the Department of Finance Ledger System. The Department provided the Committee with a breakdown of the \$32,242 and stated that the discrepancy had now been accounted for:

<u>Debits</u>		
		\$
• Salaries Clearing		19,858
• Wages Clearing		5,807
• FSC Clearing		2,844
• Deductions from Wages		37
• Payments from Vote instead of Trust Account (Corrected subsequently)		185
• Transfer A/C Vote and Trust A/C (Appropriated in one period but posted to the Trust A/C in a later period)		8,000
• Unexplained variation		381
		<hr/>
	Debit	37,112
<u>Credits</u>		
• Overseas Variation		4,210
• Salaries Unclaimed		660
		<hr/>
	Credit	4,870
		<hr/>
Total Discrepancy Debit		32,242

3.34 The Committee shares the concern of the Auditor-General that since the same transactions are posted to both the Factories' Account as well as the Department of Finance Ledger that a discrepancy of this order should emerge. Further, the department stated that considerable effort is now being directed to completing the timely reconciliation of the Factories Trust Account.²

1 Public Accounts Committee File 1980/9, op. cit.

2 Minutes of Evidence, op. cit., pp 212 and 252.

Issue Vouchers

3.35 In his Report, the Auditor-General found that a significant proportion of issue vouchers were not brought to account. The department in reply to the Committee's questions stated that the problem with issue vouchers was not that they were lost or not being brought to account at all, but rather that there was considerable delay in bringing them to account. The delay was ascribed to the fact that in the manual system in operation at GAF, it takes time to move the dockets from one point to another, to record them and to bring them to account.¹

3.36 The Department stated that it had been aware of the problem of the issue vouchers being behind for a considerable time, and certainly before the Auditor-General's Report on the matter. They claim that strenuous efforts are being directed towards rectifying the problem and that the time lag in the processing of these documents has been reduced from about 12 months in some cases to two factory accounting periods (approximately 8 weeks).² This means however, that at any point in time, there are approximately 4,000 issue vouchers outstanding,³ which would make it almost impossible to do a reconciliation of stores holdings due to the enormous number of adjustments that would be necessary. The Department acknowledged this point as valid but pointed out that there is very little that could be done manually to improve the situation beyond about a 3 week or 2,500 issue voucher delay.⁴

3.37 The Committee on the other hand feels that with the large number of staff available in the Supply Section that this situation represents a gross inefficiency. The Committee was informed that 305 personnel are employed in the Supply Section broken down as follows:⁵

1 Minutes of Evidence, op. cit., p. 223.

2 Ibid., p. 272.

3 Ibid., p. 223.

4 Ibid.

5 Public Accounts Committee File 1980/9, op. cit.

<u>Supply Section</u>	Personnel (Wages)	Personnel (Salaried)	Total ¹
Managerial and General Services		5	5
Procurement and Inventory Recording and Control		75	75
Management Co-ordination		34	34
Shop Stores Production, Tooling Etc.	90	30	120
General Stores	62	9	71
	152	153	305

These personnel service around 30,000 Component lines and about 12,000 General lines (stationery, general supplies etc.). The department explained that as a general rule, wages personnel in the Supply Section are generally storemen and those associated with moving goods from point to point, whereas salaried staff are those in the clerical areas of procurement, purchasing, inventory control and various other associated accounting operations.¹

3.38 Of the 305 personnel employed in the Supply Section, 266 handle identifiable transactions. Other staff in the Supply Section are attached to Managerial and General Services (5) and Management Co-ordination (34). The average number of transactions per employee is as follows:

Transactions GAF Supply Section

	Staff	Transactions per period	Transactions per employee, per day*
Procurement, Inventory Recording and Control	75	18,440	12-13
Stores General	71	11,370	8
Shop Stores	120	72,900	80**
	266		

* based on 20 working days per 4 week period

** Transactions in shop stores would involve simply the issue of items to production.²

- 1 Public Accounts Committee File 1980/9, op. cit.; Minutes of Evidence, op. cit., p. 226.
2 Public Accounts Committee File 1980/9, op. cit.

3.39 Regarding issue dockets, there are around 3,200 made out per period. The goods received notes (equivalent of an invoice) are 740 and procurement demands are 20.¹

3.40 The Committee does not regard the workload indicated by the statistics presented to it as excessive. Transactions numbering between eight and thirteen per employee per day for the General Stores and the Procurement, Inventory Recording and Control areas and up to 80 per employee per day in the Shop Stores areas should be well within the capability of a well managed, efficiently organised Supply Section, even with a manual accounting system.

3.41 CAC on the other hand has a total inventory of around 96,947 separate line items and the stores area employs a total of 47 people carrying out around 216,300 transactions per annum. The Purchasing Section employs 15 personnel purchasing around 20,167 lines and issuing 8,050 items each year. The total value of orders issued from 1 July 1980 to 30 June 1981 was \$11,153,802. For the purposes of comparison with GAF, these statistics may be broken down as follows:

Transactions - CAC Stores and Purchasing Areas

	<u>Staff</u>	<u>Transactions per employee</u> <u>per day*</u>
Stores and purchasing	62	16 ²

* These figures are calculated on 12 periods per annum with an average of 20 working days in each period. Adjustments to take account of recreation leave, long service leave, sick leave and public holidays would increase these figures to around 20 transactions per employee per day.

3.42 The situation at GAF compares most unfavourably with the situation at Hawker de Havilland. Hawker de Havilland has a total parts inventory of around 125,000 separate items. The complete purchasing operation at Hawker de Havilland is run by a total of around 25 people, buying in each year around \$12M worth of goods. The relative efficiency of Hawker de Havilland is reflected in the ratio of indirect to direct labour of .9/1 compared to the GAF ratio of around 1.3/1. (Commonwealth Aircraft Corporation is on .92/1)³

Goods Dispatch Advices

3.43 As with the matter of issue dockets, the Auditor-General noted that procedures for control of goods

dispatch advices were defective and a relatively large number of these documents had not been brought to account. A goods dispatch advice is a document used by GAF when dispatching goods to external organisations. It accompanies the goods. Depending on the nature of goods being dispatched and the relationship between GAF and the receiving organisation, the dispatch advice may lead to the rendering of a debit note (invoice). These documents may therefore form the basis for charging, although this may not always be the case.¹

3.44 Goods dispatch advices in GAF are generally raised at the point of issue. Once the goods have been dispatched, copies of all dispatch advices are sent to the Debtor Section irrespective of whether or not they will be the subject of a debit note. From the Debtors Section, debit notes where appropriate are raised and forwarded to the customer. The Department stated on average 700 dispatch advices are prepared in each accounting period.²

3.45 In March 1980, there were approximately 2,500 outstanding dispatch advices representing a backlog of some 3-1/2 months. The Department has however, been directing considerable effort to reducing the number of outstanding documents which has resulted in only about three of the very old dispatch advices being still outstanding at the time of hearing.³

3.46 As previously discussed in relation to issue dockets, the Committee is amazed that the management at GAF could allow such a backlog of work to accumulate, particularly since a goods dispatch advice is an accountable document and that in many cases, dispatch advices are used as the basis for billing customers. Further, the Committee is very concerned at the effect this situation must have had on the factories' cash flow situation. Also of concern to the Committee is that if the system of goods dispatch advices breaks down, as it appears has happened at GAF, possible consequences might include opportunity for the theft, loss and misappropriation of goods to go undetected for some considerable periods of time.

3.47 The Committee notes that the department introduced new control procedures for dispatch advices in March 1980 and has a continual follow up program but is nevertheless concerned that this may well be a situation of "closing the gate after the horse has bolted". It should not be necessary for departments to wait until their operations come under the scrutiny of the Auditor-General, or this Committee, before

1 Minutes of Evidence, op. cit., p. 224.
2 Committee File 1980/9, op. cit.
3 Ibid.

1 Minutes of Evidence, op. cit., p. 275.
2 Public Accounts Committee File 1980/9, op. cit.; Minutes of Evidence, op. cit., p. 276.
3 Minutes of Evidence, op. cit., pp. 217 and 277.

instituting updated and more efficient procedures. The process of review must be constant. The Committee's belief that the department must have been aware of the problem with the goods dispatch advices prior to the report of the Auditor-General was confirmed at public hearings. The Committee therefore cannot excuse or justify the lack of action prior to the Auditor-General's Report on the part of management at GAF to determine a solution to this problem.

Stocktaking of Stores

3.48 It emerged from the Committee's inquiries into the stores and supply areas of GAF that procedures for the regular and timely stocktake of stores may not be sufficient to meet the needs of a large and complex organisation. The Committee was informed that stocktaking of stores at GAF is carried out by a Stocktaking Section of the Regional Office of the Department of Industry and Commerce utilising a statistical sampling method. Under this method, a statistical sample of stores is selected and checked through a system of random numbers. Where the statistical sample fails to meet certain specifications, a full stocktake is done. These statistical stocktakes are undertaken annually.¹

3.49 The Committee concludes, that with the large number of store items at widely ranging value, that an annual stocktake based on statistical sampling is inadequate. It is felt that at some point throughout the GAF financial year, a complete physical stocktake is necessary to provide a benchmark or a start point for a more regular statistical stocktake. In any event, the Departmental stocktaking manual states in para 13.1.5 that:

"Stocktaking by statistical sampling can only operate effectively where there are high standards of internal control, storekeeping and accounting."

The Committee is not of the opinion that this situation exists at GAF, particularly in the light of the foregoing discussion of Reconciliation of Control Ledger Accounts, Issue Vouchers, and Goods Dispatch Advices.

3.50 The Committee is also concerned that the department was unable to satisfy the Committee that adequate procedures exist for the identification and subsequent disposal of obsolete and surplus stock.

Reserve Capacity Maintenance

3.51 The Auditor-General advised the Department in March 1980 following a review of transfer accounts posted to the

Maintenance of Production Capability appropriation that the reserve capacity cost subsidy had been claimed in advance of entitlement in several instances and that profits and losses on operations had not been debited or credited to that appropriation within a reasonable time after the accounting period had ended.

3.52 The Department responded to the Auditor-General in May 1980 that in future the reserve capacity cost subsidy will be claimed at the end of each accounting period. With respect to adjustments for profits and losses on operations the Department commented that before profits and losses can be isolated, various operations have to be performed by other sections of the factories. The Department did however acknowledge audit comments as valid.

3.53 The Committee was informed that the instances to which the Auditor-General referred where the cost subsidy came to be claimed in advance of entitlement related largely to instances where GAF experienced short term liquidity problems. Since GAF is unable to swell working capital by obtaining short term bank overdrafts as would be the case in a normal commercial undertaking, they claim on occasions the reserve capacity funds at the beginning of the month rather than the end.¹

3.54 Given the cumbersome accounting system in operation at GAF, the Committee was not surprised to learn that liquidity problems were experienced from time to time. It did however have some sympathy for the management at GAF for being unable to operate in a normal commercial fashion as regards short term finance. Further, the Department stated that the reserve capacity cost subsidy is now claimed at the end of each accounting period.

3.55 With regard to the debiting or crediting profits and losses to the RCM appropriation at other than prescribed intervals, the Department stated that these instances relate mainly to instances where there has been a price overrun on various operations. Under normal circumstances, these transactions would be actioned within a few weeks of the end of an accounting period. However, when a cost overrun occurs, GAF has to undertake a series of investigations to determine whether or not there is a possibility of recouping all or part of the cost overrun from the customer. Where there is a possibility, negotiations commence and the cost overrun is not declared a loss and written off against RCM until all possibilities have been fully explored. This process may take up to 6 months.²

1 Minutes of Evidence, op. cit., p. 261.

2 Ibid., p. 266 and p. 268.

1 Minutes of Evidence, op. cit., p. 221.

3.56 The Committee accepts the Departments argument in this instance as, in essence, reasonable. However we feel that mechanisms might be explored to expedite the process of negotiation for the recoupment of cost overruns on projects. The point of question to the Committee was the rationale for RCM in the 1980's and possible alternatives to achieve the same end result; the safeguarding of Australia's defence industrial capabilities. This will be taken up and explored later in this Report.

Issues Satisfactorily Resolved at Time of Inquiry

3.57 As mentioned above, a number of issues raised by the Auditor-General in his report for 1979/80 had, at the time of inquiry, been satisfactorily resolved. These points, along with action taken by G.A.F., are listed at Annex E.

CHAPTER 4

MANAGEMENT OF GAF

4.1 The second major part of this inquiry relates to effectiveness of the management of G.A.F. In order to explore this question the Committee selected various areas of management practice for inquiry. These included management reviews, staffing levels and structure, internal audit coverage and computerisation.

Management Reviews

4.2 Four major reviews of GAF have been undertaken by the various Departments having responsibility for GAF since 1971. The first of these was conducted during 1972 by a Departmental working party established under the Manager Administration, GAF and comprising various departmental officers. The terms of reference of the working party were to undertake a detailed analysis of funds control on production orders, initiate action to resolve problems in the short term, recommend long term solutions and prepare a full report for submission to the Finance and Management Services Section of GAF.

4.3 The second review was a consultancy review conducted by the Director of Accounting Policy and Systems of the then Department of Supply covering:

- . payment of accounts
- . production order overspending
- . collection of debtors accounts

This review was conducted during the second half of 1973.

4.4 The third and by far the largest management review was known as 'Project Phoenix'. This review, undertaken between 1973 and 1976 had as its objective the improved management of all operations at GAF involving changes in management structure together with the definition, design, implementation and operation of improved management information, control and reporting systems. Because of the breadth and complexity of this review, it is discussed below under separate heading along with a brief analysis of its effectiveness.

4.5 The fourth review took the form of a departmental working party chaired by the Director, Accounting Policy and Systems reporting to an executive steering committee chaired by the Operations Manager, GAF. The review was directed at the accountability of stores and documentation, non-processing of documentation, delays in processing documentation and payment of accounts.

Project Phoenix

4.6 For some years up to late 1973, GAF management and others had been seeking to upgrade GAF computer system and hardware and were also concerned about organisation in relation to the changing nature of activities. Between November 1973 and January 1974 a team comprising GAF and Departmental personnel examined this issue and from a review of the team's findings the concept of Project Phoenix emerged. In January 1974 the use of consulting assistance was considered. The objectives of Project Phoenix included the improved management of all operations at GAF involving changes in management structure together with the definition, design, implementation and operation of improved management information, control and reporting systems.

4.7 In May 1974 P.A. Consulting Services Pty Ltd was retained by the Department to provide key resources and manage a joint team to develop and implement plans to achieve Project Phoenix goals.

4.8 The development and implementation of Project Phoenix was divided into two phases. Phase 1 was undertaken between May and August 1974 and involved the investigation and analysis of the then present systems and business requirements; the definition, ranking and detailing of specific objectives; and the preparation of a comprehensive plan for implementation (Development Cost Plan). Phase 2 was planned for between September 1974 and March 1976. It involved the progressive development and introduction of the various changes recommended in the Development Cost Plan; the development within GAF of its own ongoing capability in this area; and the provision of training and experience for other departmental resources, so that these might be applied elsewhere.

4.9 The team size averaged the equivalent of twenty people over the period, of which about 40% were computer analysts and programmers. The gross benefits were estimated at a total of around \$1M per annum in tangible terms. Equally important objectives were the operating effectiveness at GAF, providing service, satisfaction commitment to GAF customers.

4.10 The specific objectives identified in the DCP for implementation in Phase 2 included:

- . *Restructuring and Redirection of Organisation.*
The organisational structure and direction required major changes to emphasise customer market requirements and the project nature of GAF's business.

- . *Project Oriented Systems.* This major organisational change also required new systems concepts and detailed procedures so that project planning, control and cost/schedule reporting would be effective.

- . *Functional Systems.* Within functions, most existing defined procedures were found to be adequate but ineffective either through misuse, inaccuracy or tardiness.

- . *ADP Support Services.* ADP service was seen as providing the only effective long term answer to GAF's information processing requirements.

- . *GAF Self Sufficiency in Systems Development.*
A key objective stated in the Development Cost Plan was to develop a capability at GAF to maintain and extend its system dynamically to meet its future business needs.

4.11 Eighteen months after the development of the initial Development Cost Plan in Phase 1, and as forecast in the Development Cost Plan, a further development program with a horizon of two years was drafted by the Project Phoenix team with the detailed participation of a GAF executive steering committee. Its major components included;

- . Organisationally, extension of the definition and establishment of certain new functions, and clarification of modified functions with the development of flexible manpower pooling, planning and related procedures. This programme was the responsibility of the GAF Personnel Manager.

- . Systems development of present and future modules of two major processing systems, one covering costing and financial aspects, the other covering physical task planning and control. These were also intended to provide the basis for project management, planning and control.

- . Control. Responsibility for ongoing monitoring and control of this programme, as a formal GAF management process, was undertaken by the GAF executive.

4.12 The total cost of the development and implementation of Project Phoenix excluding the cost of GAF and Departmental participation in Phase 1 and 2 were in excess of \$930,000. This can be dissected as follows:

Management consultant's fee	\$450,310
Supply of computer equipment	\$463,224
Airconditioning and building alterations to house computer equipment	\$ 17,587
TOTAL	<u>\$931,121</u>

4.13 The implementation of the Development Cost Plan for Project Phoenix encountered a number of major difficulties. Towards the end of their involvement in the project, P.A. Consulting Services Pty Ltd presented a review of the Project containing a dissection of problems encountered and their implication. These are examined here in detail as it is the Committee's belief that they tend to highlight many of the difficulties under which GAF operates as well as prevalent management attitudes in the factories.

- Industrial Bans. The start of implementation of the Development Cost Plan coincided with a separate investigation of industrial relations at GAF, in an atmosphere of employees concern about GAF and their future. Project Phoenix and industrial relations rapidly became entwined. As a result various demands, with bans on Phoenix activities, were introduced and lasted till mid 1975. These affected developments in several areas.
- Computer Systems and Acceptance. It was considered when preparing the Development Cost Plan that procurement of the required new computer equipment could be arranged extremely expeditiously, with some significant shortcuts in Public Service computer acquisition procedures. In the event, GAF did obtain its computer approval much faster than normal but not as quickly as originally planned. This delay, along with other factors, led to delays in the detailed ADP design and implementation phase. The result was that operation of the planned computer system was delayed by nine months. Similarly, the implementation of several ADP systems was almost concurrent rather than phased, with consequent impact on the users and project teams.
- Top Level Organisation. Approval for the new top level organisational structure was planned for March 1975. Through changes in planned arrangements and detailed requirements, the formal proposal was not submitted until October 1975. P.S.B. approval to the new structure was given on 10 September 1976. The five executives commenced in the newly appointed positions during the last

quarter of 1976. In the interim, ad hoc arrangements were introduced from December 1974 to align available staff resources to the required structure with emphasis on what were seen as priorities and on practical action in the short term. P.A. Consulting Services Pty Ltd indicated that these arrangements were only marginally satisfactory.

- Appointment of Manager - Project Phoenix. The Development Cost Plan aimed for appointment of a manager during January 1975, his progressive induction during the next six months, followed by formal transfer from P.A. to him of a project management responsibility by July 1975. The position was established in January but used on an ad hoc basis. In April-June 1975, arrangements for advertising the position for final appointment were commenced but interviews were not held until November of that year. After further delays, an acting manager was appointed in February 1976. The major effect of this was that the project as a whole was viewed by many GAF staff as external and probably temporary in nature. In addition, valuable time for training, experience and transfer was lost.
- User Resources in Support. P.A. Consulting Services Pty Ltd noted that in most cases, despite agreement during the review of the draft Development Cost Plan, the planned commitment of user resources from affected sections at GAF was substantially deficient. The reasons given, claim P.A. Consulting Services Pty Ltd, were usually other priorities and in some cases these were acknowledged as valid. The result was however that system development and implementation was seen too often by sectional management as external and imposed.

4.14 There are a number of major points to be drawn out of this examination. Firstly, the industrial bans which plagued the implementation phase of Project Phoenix between November 1974 to June 1975 would appear to confirm Committee views that GAF lacks an enlightened approach to industrial relations. The issue of industrial and staff relations was addressed in depth in para 5.7 of the Development Cost Plan and covered such areas as redundancy and relocation of staff, demarcation, attitudes and communication with staff and resistance to change. Nevertheless, problems emerged. Whilst recognising that in any organisation undergoing change resistance may be encountered from staff for many reasons including strong views on maintenance of the status-quo or because they do not understand the proposed changes, it is the strongly held view

of the Committee that problems of this nature are up to a point, avoidable. Mechanisms for a two way dialogue between staff and management will always reduce resistance to change and provide a basis for common understanding and purpose. This was not evident from the evidence presented to the Committee. The theme of industrial relations will be further examined under specific heading later in this chapter.

4.15 The second major point to emerge was that of the length of the GAF decision chain. Being part of a Government department, GAF lacks autonomy in the decision making process. Unlike a private organisation, factory management was unable to proceed to immediate equipment purchase for the necessary computer hardware, nor was it able to act with sufficient speed to effect the necessary organisational and staffing changes. These points are demonstrated clearly in the Decision Flow Charts attached at Annex B. It is the Committee's observation that at almost every stage of the management process, the General Manager of GAF is in the position of being 'second-guessed' by other departments of Government, remote from the realities of the factory's day to day operation.

4.16 The point of greatest concern to the Committee was what would appear to be an almost negligent lack of commitment to Project Phoenix on the part of factory management. This is evident firstly from the laxity in filling the position of project manager resulting in the loss of 12 months of valuable training and experience and secondly through the lack of support from user resources. The present day attitude of management to the project was further highlighted at the inquiry when the senior management of the factory or the Department were unable to display more than a most rudimentary knowledge of the project. Bearing in mind that the project cost almost \$1M and was designed to be an on-going system of review with potential savings of around \$1M per annum, the Committee regarded this situation as most unacceptable.

4.17 From the evidence presented to the Committee it is difficult to make an assessment of the efficacy of Project Phoenix. What is apparent however is that problems in many basic areas of financial control and accounting procedure and practice persist. In addition, the Committee's experience during the inquiry was that the management of GAF was often unable to provide to the Committee elementary commercial information on the workings of the factory that Project Phoenix was designed to produce.

Effectiveness of Management Reviews

4.18 From the evidence presented to the Committee, there is little reason to believe that the four management reviews

undertaken have contributed significantly to effecting corrective action in the accounting irregularities at GAF.

4.19 The first two reviews discussed above were directed specifically to the financial areas of GAF and in particular the issue of funds control on production orders. Recommendations implemented from these two reviews included:

- A special investigation cell was created within the Costing Section to identify and breakdown costs on all overspent orders. The information was then passed to the Sales Order Section which had been placed under the control of the Assistant Manager, Administration.
- In the Sales Order Section, information was sought from the various Cost Centres concerned as to the technical or other reasons for the over-expenditure incurred. Upon receipt of this information requests were initiated to customers seeking additional funds to cover the over-expenditure or recommendations were made to Management to write off the over-expenditure as a loss on operations.
- Longer term recommendations of this system addressing the introduction of ADP monitoring systems and Departmental pricing policy on the inclusion of contingencies in factory quotations were considered within the broader spectrum of the terms of reference of Review No. 2 undertaken in 1973.
- The recommendations arising from Review No. 2 form the basis of the present operational arrangements for the three Finance Sub-Sections, Commercial, Debtors and Creditors. This review highlighted the need for, and introduced improved systems and procedures to monitor the flow of documentation, and critically examined management attitudes at the middle and lower management level in the accounting area. The Department claimed the introduction of fixed price-quotations at this time significantly reduced the incidence of production overspending on orders.¹

4.20 In the light of the efforts of the management of GAF to effect corrective action in the area of overspending against orders, the Committee was very disturbed indeed to note that every report of the Auditor-General from 1971/72 to 1977/78 contained critical reference to this issue. Indeed, in para 3.21.2 of his 1977/78 Report, the Auditor-General noted that:

1 Public Accounts Committee File 1980/9, op. cit.

" . Over-expenditure against orders showed little or no improvement on the position reported in successive Reports since 1971-72 (paragraph 3.18.1 in 1976-77) and to the situation recorded in the one hundred and forty-sixth report of the Joint Committee of Public Accounts presented to the Parliament in October 1973.

. The defects in accounting control in respect of over-expenditure against orders were similar to those disclosed by Audit in the general accounting and management controls with which they are closely integrated."

4.21 The issue was again critically raised in the Auditor-General's Report for March 1981 and as far as the Committee is aware, the situation still exists.

4.22 Clearly then the first two management reviews have been ineffectual in achieving their aims. Of more particular concern to the Committee though is the fact that it would appear that successive managements of GAF have at no time successfully directed effort toward rectifying the situation.

4.23 The fourth management review, aimed at the accountability of stores and documentation, delays processing documentation and payment of accounts, would appear to have experienced little more success. Earlier sections of this Report examine in detail the continuing irregularities in the stores and accounting areas of GAF.

4.24 With regard to the efficacy of this series of management reviews, including Project Phoenix, the Auditor-General in para 2.18.2 of his Report for 1978/79 said;

" . It is a matter of continuing concern that, notwithstanding the number of major reviews of accounting undertaken by the Department since 1971, the results of audit as reported above indicate continuing serious deficiencies in accounting procedures and practices and management control. A particularly disturbing aspect is the effect the continuation of this situation will have on the factories' ability to prepare and present accurate financial statements, pursuant to the determination made under section 41D of the Audit Act, in view of the demonstrated failure of the financial and cost accounting systems to ensure all costs are brought to account correctly and distributed properly. As long as the deficiencies in these systems persist it is evident any financial statements prepared by GAF will also be deficient in material aspects."

Staffing at GAF

4.25 Of the 2466 personnel employed at GAF, approximately 50% are employed under the Public Service Act¹ and the remainder under the Supply and Development Act 1939. These may be broken down as follows:

Public Service Act Staff

Executive	6
Engineers	173
Other professionals	10
Technical Grades	386
Drafting Grades	68
Quality Assurance	60
Foremen	105
Clerical/Admin	357
Keyboard	67
Other	16
	<hr/>
	1248

S&D Act Staff (Operative)

Skilled	600
Semi-skilled	324
Unskilled	126
Apprentices	168
	<hr/>
	1218
	<hr/>
Total	2466

4.26 The Committee was interested to examine a number of staffing issues at GAF as it believes that in many areas, staffing policy can impact upon the efficient functioning of any organisation.

Working Conditions

4.27 The first observation of the Committee in this area was the conditions of work of employees, particularly those in the clerical fields. The Committee was concerned about some of the interior condition of some of the buildings, the condition of furnishings, floorcoverings and general staff facilities. We would say without hesitation that at the time of inspection, these facilities were among the worst the Committee had ever seen in any Government organisation and certainly comparing most unfavourably with any similar facilities inspected in other areas of the aircraft industry. It is the Committee's opinion that this is the result of decades of serious neglect and that this obvious lack of

1 Public Accounts Committee File 1980/9 op. cit.

concern and consideration for employees on the part of management must impact upon management/staff relations and general efficiency.

4.28 In response to questioning from the Committee on this issue, the General Manager of GAF acknowledged that physical facilities, particularly those of salaried staff are not up to standard but stated that programs to redress this situation have been submitted for inclusion in the works program. He identified current budgetary exigencies and the need to get approval from central office as possible impediments to this process.¹

Remuneration

4.29 Remuneration paid to senior and middle management at GAF is another area of concern to the Committee. Whilst accepting the fact that at GAF there are many able and dedicated individuals, the Committee believes that as a general proposition, a commercially oriented organisation will only attract and retain the best available personnel where salaries and working conditions are at least on a par with similar organisations elsewhere. In response to questioning on this issue, the department acknowledged that in the two levels immediately below that of General Manager the salary differential in favour of private industry would be in the order of 10% to 30%. Further, in the more junior levels, a differential of more than 30% may occur in some areas.² The department added that because of this situation it is often difficult to recruit quality staff from outside the Public Service.

4.30 By way of comparison, the Committee sought independent advice from one of the major professional personnel consultancies and discovered that the position of General Manager at GAF, which is currently a level III Second Division position with a salary of \$45,400 per annum (as at 22 October 1981), would attract a significantly higher salary.³

Industrial Relations

4.31 As foreshadowed in the foregoing section on management reviews, the Committee is of the opinion that there is considerable scope for improvement in the field of industrial relations at GAF. During inspection of GAF, the Committee gained the strong impression that morale at the factories was not good. This was confirmed by the General Manager of GAF during the inquiry who ascribed the situation to a number of factors including the working environment and

- 1 Public Accounts Committee File 1980/9 op. cit.; and Minutes of Evidence, op. cit. p. 457
- 2 Minutes of Evidence, op. cit., p. 449.
- 3 Committee File 1980/9, op. cit.

the uncertainties that apply from time to time in the workload of the factories. The Committee feels that these factors also contribute to the level of industrial dispute at GAF.

4.32 The Department acknowledged that industrial relations at GAF were not easy. They stated that over the last several years there has been a continuing active involvement including dispute in a number of areas. One of these resulted in a four week strike in March 1980. The Department did claim however, that industrial action at GAF was more in response to the larger community trends on the industrial scene (35 hour week etc.) rather than on local issues.

4.33 The Committee noted that at Hawker de Havilland, where the factory is dependant to much the same degree on defence work as GAF, industrial relations were by and large far more successful. It was the Committee's impression that through various consultative mechanisms including regular monthly staff-management discussions, many potential areas of dispute had been avoided. This is evidenced by the significantly lower level of industrial confrontation at that organisation. We believe that management at GAF has not been as aware as it might have been to the trends in the area of industrial relations over the last several years and that considerable scope exists to ease the situation.

4.34 In addition to a lack of awareness of recent trends, the Committee believes that industrial relations at GAF are greatly handicapped by the length of decision chain and lack of autonomy of the General Manager in responding to industrial issues. Under current arrangements, the General Manager, GAF has only limited authority to respond to industrial issues and no authority to enter into collective bargaining arrangements involving wages, salaries or conditions. He has only limited stand down authority (one day only). To resolve major issues, he is required to involve the Department of Industry and Commerce in Canberra who then co-ordinate a response from the Public Service Board, Department of Industrial Relations and the Public Service Arbitrator. Major decisions in disputes are usually taken at Ministerial level.¹

Internal Audit at GAF

4.35 With the critical state of affairs with regard to adherence to established procedures and managerial efficiencies at GAF, the Committee was concerned to examine the level and efficiency of internal audit arrangements. The Committee was informed that GAF has no internal audit facility of its own, but rather shares a facility with other Government factories in the Victorian region and the regional offices of the Department of Industry and Commerce.²

- 1 Committee File 1980/9, op. cit.
- 2 Minutes of Evidence, op. cit. p. 440

4.36 Under the arrangements in place when Department of Productivity had responsibility for GAF, the Victorian Regional Directorate had an Internal Audit staff with an establishment of eight but with a ceiling of seven persons consisting of:

- Senior Internal Auditor Gr. 2 (Class 7)
- Senior Internal Auditor Gr. 1 (Class 6)
 - two positions
- Internal Auditor Gr. 2 (Class 5)
 - three positions
- Internal Auditor Gr. 1 (Class 4)
 - two positions

The average annual occupancy of this unit during the past four years was 5.16 persons. The regional directorate reported direct to the Chief Internal Auditor (Class 9) within the Finance and Management Services Division of the central office of the Department.

4.37 With the abolition of the Department of Productivity in November 1980, the regional internal audit positions in Victoria were transferred to the Department of Science and Technology. Support was provided to the internal audit program in the Defence production areas of the Department of Industry and Commerce in the regional areas by the previous Department of Productivity staff under cross servicing arrangements until 30 June 1981. Unoccupied positions were not filled during that period.

4.38 As at the time of the hearing, the positions available for internal audit field staff in respect of Department of Industry and Commerce activities in the Victorian regional directorate comprised:

- Senior Internal Auditor Gr. 2 (Class 7) one position
 - occupied on Higher Duties basis.
- Senior Internal Auditor Gr. 1 (Class 6) one position
 - occupied on temporary transfer.
- Internal Auditor Gr. 2 (Class 5) two positions - one unoccupied.

The workload for these positions includes eight production establishments (including GAF) plus other Departmental activities. Although at the time of the hearing these positions had not been created within the Department of Industry and Commerce, the department claimed that urgent organisation action was in hand.¹

¹ Committee File 1980/9, op. cit.

4.39 The Committee is concerned with the low number of staff in such a large, critical and complex area of Government operation as the Defence production areas. It considers that even under the previous Department of Productivity arrangements that seven auditors, mostly at a relatively junior level, would have been sufficient only for the most simple and cursory audits of operations and certainly not able to carry out investigations of the breadth and depth required at an organisation such as GAF. The schedule of internal audits actually undertaken at GAF over the last three years attached at Annex F demonstrates this point clearly. Current interim arrangements of four positions are clearly inadequate. The Committee will await with interest the result of the organisational action currently in hand with the Department.

4.40 The Committee is also concerned at the high level of staff turnover in the internal audit areas in the Department of Industry and Commerce servicing GAF. Turnover in internal audit in the Victorian Regional Office of DIAC has averaged 70% p.a. over the last four years, not including internal movements. Whilst recognising that this phenomenon is not confined to that department, the Committee is concerned at the lack of continuity of experience which it considers would be particularly necessary in Government factories.

4.41 Staff turnover statistics in the internal audit areas having responsibility of Defence production undertakings, from 1 July 1977 to 30 June 1981 are at Annex G.

Computerisation at GAF

4.42 The level of computerisation in stores and financial administration areas of GAF is the cause of some concern to the Committee. As mentioned previously, computerisation for GAF was an outcome of the Project Phoenix review. The system purchased was a Burroughs B1726 business computer. The programs run on this computer are listed at Annex H.

4.43 At the time of inquiry, negotiations for the purchase of additional computing equipment were well advanced with delivery expected around October 1981. The Department expected that the new equipment would significantly enhance the computing capability of GAF. The Committee is however concerned about the continuation of the bias of allocation of computing resources away from administrative type functions towards the scientific and technical production areas. This bias is evident from the programs listed at Annex H and also from the priorities identified by GAF management for the introduction of the new facilities. These priorities were identified as:

1. Numerical Control Programming Assistance which is the control of movements of a five axis milling machine by means of data held on the computer. This has significant advantages for GAF in terms of complexity of shapes they are able to produce and the speed with which they can operate.

2. The second priority identified by the Department is the transfer of some of the programs currently running on the Burroughs computer so that they are available in a more timely manner. These will include the establishment of a bill of material which is a fundamental document for supply action and planning. This will commence around October 1981.

3. Order processing, which will be concerned with the progressing of the procurement function. This is concerned with relating the progressing of actions within the procurement function with the schedule of parts and equipment in the production line.

4. The fourth priority is in the area of production planning. This involves the storing of production technology on computer, rather than in the individual experience of employees. It is anticipated that this process will begin in mid 1982 and continue for many years.

5. The fifth priority is a program called 'stock status' which is the beginning of the computerisation of the parts and materials inventory and the transfer to computer of the manual stock records. This is scheduled to commence around mid to late 1982.¹

4.44 Whilst the Committee accepts that the allocation of limited computing resources to competing priorities within GAF is a difficult task, particularly within the context of the work anticipated under offset arrangements associated with the New Tactical Fighter project and the work associated with the new RAAF trainer it cannot accept the neglect of basic accounting and control functions. The maintenance of out of date manual accounting systems is, in the Committee's view totally inconsistent with the requirements of large scale manufacturing undertakings, particularly those with responsibilities to the Parliament and the taxpayer.

1 Minutes of Evidence, op. cit., p. 422.

CHAPTER 5

ISSUES ARISING FROM THE INQUIRY

5.1 It became obvious to the Committee throughout the course of this inquiry that there are a number of general points to be made with relation to GAF. These include principally the organisation and rationalisation of the aircraft industry as a whole and the future of the current arrangements for funding Reserve Capacity Maintenance. The Committee in this section is not seeking to make a definitive statement on these important issues but simply to highlight, from our experience, areas worthy of further detailed objective examination by government.

Structure of the Aerospace Industry

5.2 The structure of the aircraft industry in Australia and particularly the relationship of GAF to the other two major contractors (Commonwealth Aircraft Corporation and Hawker de Havilland) is open to some critical discussion. In 1975 the Industries Assistance Commission (IAC) made a series of recommendations on the organisation and structure of the aerospace industry.¹ These included, inter alia:

- Implementation of the proposal for consolidation at Bankstown of Hawker de Havilland facilities currently located at Lidcombe and Bankstown.
- Implementation of the Commonwealth Aircraft Corporation restructure proposal at Fishermen's Bend. This proposal involved the restructure of Commonwealth Aircraft Corporation operations and reduction of its size by about 50%. It proposed that its role as a defence contractor be reduced essentially to that of jet engine overhaul and manufacture on the understanding that it would be the chosen jet engine contractor.
- Scaling down of capacity at GAF to the level consistent with both the likely volume of future workload and the Government's Defence production requirements.
- GAF to be made a statutory corporation and GAF, Commonwealth Aircraft Corporation and Hawker de Havilland to continue to operate as separate entities.

The basic thrust of the IAC recommendations were that each of the major contractors (in its rationalised form) should be autonomous and specialise in those fields of defence work in which it had already acquired expertise. Whenever possible however competition should be encouraged under a system of competitive tendering particularly in the areas of airframe

1 Industries Assistance Commission Report, op. cit., p. 59.

sheet metal manufacture, general machine shop manufacture and electronics and avionics overhaul.

5.3 Under current arrangements, GAF lacks the autonomy and flexibility normally required by a large commercial undertaking. Throughout this inquiry we have touched upon a number of areas which, in our opinion have resulted in GAF being at a considerable disadvantage relative to its competitors. It is the Committee's belief that an organisation such as GAF which has, by the nature of its role, to operate in a commercial environment, should have the same unrestricted flexibility and autonomy as has its competitors. Similarly, the Committee believes that the number of the accounting problems at GAF must reduce if it were subject to the same cash-flow/profit making incentives as a private corporation.

5.4 Whilst the Government's response to the IAC recommendations was largely positive, there was a significant shift of emphasis through the failure to make GAF a statutory authority. The Committee takes note of the cogent reasons why this was not done, but would however endorse the IAC recommendation in so far as it highlights the need to remove from GAF many of the encumbrances of its formal attachment to the mainstream of Government administration.

Reserve Capacity Maintenance

5.5 Apart from the problems identified by the Auditor-General, associated with the administration of Reserve Capacity Maintenance within GAF which have been discussed earlier in this Report, the Committee was interested to examine the efficacy of this appropriation in achieving its aim; the maintenance of Defence production capability. This area of investigation is closely related to and impacts upon the strategic need for the industry and its current structure.

5.6 It would appear that the attitude of the Department of Defence to the strategic need for the industry remains basically unchanged from that stated in a submission on strategic considerations put to the IAC and published in its 1975 report on the aerospace industry. Briefly summarised, the Department considers that the primary defence role of the aerospace industry is to provide effective support to the Services in the areas of design and development, servicing and repair, the manufacture of spares and modification kits, the incorporation of modifications and the provision of technical services. It regards such support as necessary for the effective peacetime operation of military aircraft by the Defence Force and as providing the base from which expansion in an emergency could, if necessary, be implemented.

5.7 An indigenous capability to redesign existing equipment to meet changing operational requirements, to

correct inherent deficiencies or to adapt designs to local environmental and operating conditions is regarded by the Services as essential. The maintenance of this capability, which provides a measure of self-reliance and independence from foreign organizations, requires the local availability of aeronautical design skills across all the relevant disciplines such as aerodynamics, structures, materials, avionics systems, propulsion and manufacturing processes. Occasionally there is a need to draw on these skills to satisfy specific requirements which might not be adequately met by products obtainable from overseas (e.g. Ikara).

5.8 From the viewpoint of the Services it is not essential that their aircraft or other prime equipment be produced locally. It is however accepted that in the case of indigenous design projects there must obviously be the ability and capacity to manufacture and evaluate prototypes and to carry through the subsequent production programmes. It is also recognised that the Services have benefited from the better level of technical and maintenance support behind those aircraft or engines of overseas design that have been manufactured locally.

5.9 The continuing objectives of the Department of Defence as expressed in the 1976 Defence White Paper include "... the sustaining of an aircraft industry able to provide support and selective manufacturing capability".

5.10 Within this context of need, it would appear to the Committee that a considerable amount of excess capacity might exist within the industry, much of the cost of which is being borne by the Maintenance of Production Capability Appropriation. In addition, the Committee is not convinced that sufficient planning has gone into relating the technological capacities being retained at GAF and the defence needs in terms of the various potential threats to Australia's strategic environment and the warning times associated with each possibility.

5.11 A further area of concern to the Committee is that many of the components required and most of the raw materials for the manufacture of aircraft in Australia including Nomad are imported from overseas sources. Those then are equally as vulnerable to the possibility of an interrupted supply line as the supply of ready made aircraft. The Committee believes that considerable scope exists within the aerospace industry for the rationalisation of technological capability to accord with real defence needs coupled with a redirection of reserve capacity maintenance funds to develop within Australian private industry the capability to produce in-house a greater proportion of components and raw materials required.

Conclusions and Recommendations

5.12 The Committee realises that any judgement of a critical nature regarding GAF must be tempered with an understanding of the many problems that a commercially oriented organisation operating within a Public Service framework must face. We are concerned particularly with the extraordinarily long decision making process between the General Manager, GAF, the head office of the Department in Canberra and the various Government instrumentalities which have an input to the decision making process such as the Departments of Defence, Finance, Administrative Services, Public Service Board etc. We believe that this process severely limits the General Manager's ability to respond in a timely and effective fashion to day to day management situations. The inflexibility and inefficiency caused by this approach should, in our opinion, be eliminated. (Attachments at Annex B refer).

5.13 However, the Committee feels that the multitude of problems facing GAF is due to the lack of a co-ordinated and integrated approach to their responsibilities by factory management over the last decade and a lack of prompt action on factory issues by the Department in Canberra. The Committee cannot justify or excuse the neglect of many of the basic accounting procedures and functions of GAF (issue dockets, reconciliation of ledger accounts, goods dispatch advices etc). Nor can it excuse the lack of action by the management at GAF to rectify these irregularities, particularly since many have been the subject of repeated comment by the Auditor-General over the last several years. The Committee is in no doubt that there has been a lack of commitment by senior management at GAF and the Department of Industry and Commerce to the observations of the Auditor-General and a regrettable tardiness in the control of existing systems and implementation of new systems to take account of the changing requirements of modern business practice.

5.14 Management at GAF have consistently proven over the last decade their inability to react to criticism directed at implementing remedial action, or even to rectify problems of this nature that they themselves have identified. In addition to this, given the collective magnitude and regularity of problems at GAF, the Committee believes that any specific recommendation would be simply a 'band-aid' approach when what is needed is a complete overhaul of management practices. The recommendations the Committee has made therefore are restricted to the larger issues of our inquiry.

• Review of Role and Structure of GAF

5.15 The Committee is of the firm opinion that if GAF is to function efficiently in a commercial environment then many of the encumbrances of its formal attachment to the

mainstream of Government Departmental administration must be removed. Whilst recognising that there are a number of ways by which this objective may be achieved, possible options might include:

- GAF be reformed into a statutory corporation.
- Negotiate a tripartite aerospace corporation with Hawker de Havilland and Commonwealth Aircraft Corporation with 1/3 of shares being vested in the Commonwealth.
- Rationalise some of GAF's activities and establish a company with a majority shareholding vested in the Commonwealth.

5.16 The Committee recommends that GAF be subject to an immediate high level review with the object of eliminating the many and varied problems that we have identified and place GAF in an environment where the possibility of their recurrence is minimised. To this end, the Committee considered the options for the structure of GAF and concludes that the most acceptable solution would be to reform GAF into a statutory corporation.

• Financial Statements

5.17 Irrespective of the outcome of any review of GAF, the Committee recommends that the Department of Industry and Commerce, in close co-operation with the Department of Finance and the Auditor-General's Office develop mechanisms to rationalise the financial reporting arrangements of GAF. This could include one set of accounts prepared and submitted to the Production Board as statements examined by the Auditor-General, which are then presented to the Parliament as a record of the financial achievements of GAF. In its examination, the Department of Industry and Commerce should address the related issues of the methods and formulae used to determine notional costs and a common practice for use in all factories for the valuation of Work In Progress and Stores.

• Accounting Procedure and Practice

5.18 The Committee recommends that as a matter of priority, an expert team be formed which may comprise officers of the Departments of Industry and Commerce and Finance, the Auditor-General's Office and the Public Service Board, headed by a firm of private consultants, to examine in detail the adequacy of all administrative procedures in GAF and in particular financial reporting and inventory control procedures. This team should make recommendations on the updating of procedures with a view to the early implementation of a workable system, preferably computer based. The Committee further recommends that a prime task of the team be

to supervise a complete stocktake of stores at GAF and to make recommendation on the development of new systems based stocktaking procedures with adequate mechanisms for the identification of obsolete and surplus stock items. The Committee expects to be advised within six months of the tabling of this Report of the results of this investigation and the timetable for implementation.

. Maintenance of Production Capability

5.19 The Committee recommends that, in the absence of any comprehensive review of Defence aerospace needs within the context of Australia's various possible strategic scenarios, such a review be undertaken as a matter of priority. It should encompass all work currently being undertaken at GAF and related organisations including the aerospace technologies and expertise required to be retained for Australia's real defence needs in both the short and the long term. In addition, such a review should address the related issue of encouraging Australian manufacturers to produce the raw materials for aircraft maintenance and production.

. Defence Purchasing Arrangements

5.20 To secure a viable long term aircraft industry in Australia and to minimise the effects of periodic fluctuation in workloads at the Government Aircraft Factories, the Committee recommends that the Government consider, subject to normal commercial considerations, the greater utilisation by Departments and Statutory Authorities, the production capabilities of GAF.

BACKGROUND INFORMATION ON RESERVE CAPACITY
MAINTENANCE IN GOVERNMENT FACTORIES

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DEPARTMENT OF INDUSTRY AND COMMERCE

CANBERRA, A.C.T. 2600 TELEGRAMS DEPRODY TELEX: 82063 - TELEPHONE 48 2111

In Reply Quote

The Secretary,
Joint Parliamentary Committee of
Public Accounts,
Parliament House,
CANBERRA A.C.T. 2600

- 3 SEP 1981

EXPENDITURE FROM THE ADVANCE TO THE MINISTER FOR FINANCE
1980-81 - RESERVE CAPACITY MAINTENANCE

Reference is made to your memorandum 1981/5 of 17th August 1981.

The requested statement on the current policy on estimating for the appropriation and on financial administration is set out below.

Reserve Capacity Maintenance

With the exception of Clothing Factory Coburg and Aircraft Engineering Workshops Pooraka, which are both self-supporting, recovering full factory cost from customers, all other DIAC factories receive an appropriation for RCM to enable full recovery of costs in conjunction with the operation of the factory Trust Accounts.

The purpose of the Reserve Capacity Maintenance (RCM) appropriation, which has existed in one form or another since 1945-46, is to meet various costs which are incurred in maintaining production capability in Government defence factories for emergency defence needs, but which are not covered by receipts arising from current use of that capability.

If full factory costs were charged to customers, prices would be at such a level that it could appear more economic for them to go elsewhere, particularly overseas, for their requirements. Thus the appropriation for RCM is provided to compensate for the costs not absorbed in prices. This method of charging relieves the equipment and stores appropriation of the Department of Defence of the burden of maintaining production capability.

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The requirement for funding of unabsorbed costs in Government Factories from this item varies from factory to factory. The amount of appropriation required is influenced by:-

- the workload levels expressed in forecast production hours;
- the workload mix - rates at which customers are charged for work varies between classes of customers. Commercial customers are, charged at higher rates than Department of Defence and therefore contribute more to overheads;
- different overhead costs between factories owing to the differing natures of the products and the indirect support required.

The budgeting process is the means by which funds required from RCM are determined. It is also the means by which pricing rates are determined for recovering costs from customers.

The method of determining the RCM requirement has changed over the years. From the late fifties until 1976/77 all factories arrived at their RCM requirement via the same method based on a charging rate at Normal. The Normal rate is an assessed rate which would recover all costs if the factory was reasonably fully employed on a single shift basis. There is only one factory that still operates under this method of 'Normal' and that is the Government Aircraft Factory.

In 1976/77 the Munitions factories workloads were at a very low level and a new basis for charging defence customers was approved by the Treasurer, and the Ministers for Defence and Industry & Commerce. This charging rate is described as the Defence Munitions Manhour Rate (DMMR). The underlying assumption was that a very low charging rate (lower than Normal) would encourage Defence procurement officers to place orders with the factories rather than elsewhere resulting in overall savings to the Defence Vote which was already meeting the cost of reserve capacity.

The new basis entailed a different method for arriving at RCM requirements for 'DMMR Factories'. The DMMR factories are:-

Ordnance Factory, Maribyrnong
Ordnance Factory, Bendigo
Small Arms Factory, Lithgow
Ammunition Factory, Footscray
Munitions Filling Factory, St Mary's
Explosives Factory, Maribyrnong
Explosives Factory, Albion
Explosives Factory, Mulwala

The DMMR rate is set in accordance with a formula and is agreed by the Departments of Finance, Defence and Industry & Commerce. It is determined prior to the commencement of each financial year and remains fixed for the whole of that year irrespective of any cost variations which may occur during the year. This has administrative benefits particularly for Defence who do not have to provide additional funds on numerous individual orders to cover price increases.

There is one rate charged to Defence customers by all Departmental Munition factories. Customers other than Defence do not obtain benefit from this low charging rate as prices are determined on what the market will bear.

Calculation of RCM

The RCM is arrived at through the budgeting process under both accounting methods (i.e. Normal and DMMR). Details included in the calculations for each method are:-

DMMR - Munition Factories

The principle of recovery under DMMR is that all direct costs are funded through the Trust Accounts and the indirect expenses are funded from the RCM appropriation.

The following costs are charged to RCM. They are estimated at the commencement of the year on budgeted information.

- (1) All salaries, except those employees who actually undertake work which is recoverable from customers.
- (2) Wages of all indirect labour support except those employees who actually undertake work which is recoverable from customers.
- (3) All overheads such as indirect supplies, power, telephones, stationery etc., except those directly recoverable from customers.
- (4) Time of direct employees not booked to recoverable work.
- (5) Losses incurred on work undertaken for customers. These losses can arise from many causes, e.g. unforeseen exchange rate losses, usage of materials or labour in excess of the amounts provided for in selling prices, etc.
- (6) Cost escalation during the year. Once the costing and pricing rates are set at the start of the financial year, they are fixed for the year for Defence customers and consequently National Wage decisions etc., during the year are not passed to these customers but are funded from RCM.
- (7) Any variation between the costs actually funded by the Trust Account and the budgeted amounts recovered by the application of the DMMR.

The DMMR is a weighted average departmental rate which results in variations from factory to factory. Also the DMMR is based on factory budgets. Any variation of actuals from these budgets for items such as available effective manhours, overtime penalty payments, leave bonus, sick/repatriation/compensation leave etc will be reflected in RCM.

A recent change to this method has resulted in an amount of overhead being recouped via the charging rate and thus reducing RCM requirements in categories (1), (2) and (3) as mentioned above. By 1978/79 the then Department of Productivity was dissatisfied with the DMMR because as Defence workload increased the effect was to increase the charge to RCM. The rate is now based on the rate for a direct worker plus an incremental adjustment to cover additional budgeted indirect costs resulting from the movement in workload and employment levels above that existing in 1977/78. However all cost escalation during a year remains a charge to RCM.

Normal - G.A.F.

As mentioned previously GAF is the only Departmental factory using this rate for all factory costing.

Under Normal, all costs are initially paid through the Trust Account and the RCM portion is reimbursed to the Trust Account. RCM under this method is the result of the application of Normal Manhour Rates, (which are calculated at the commencement of the year and updated for National Wage Decisions etc) to the current level of operations.

The Normal rate (which is defined as the cost per manhour for direct labour and factory service cost which would be experienced if the factory was working at a reasonably fully employed level on a single shift basis) is assessed. The Factory Service Cost and Reserve Capacity Cost Budget is then prepared, which forecasts the cost, at current rates, of Direct Labour and Factory Service Cost appropriate to the level of activity expected in the budget year. By the application of the Normal rate to the Factory Service Cost and Reserve Capacity Cost Budget, a forecast is made of the amount chargeable from customers and the amount to be recovered from RCM. Estimated usage/pricing losses, and estimated variations from standard are added to arrive at the total estimate for RCM.

Financial Administration

The above methods provide the basis for the Department's estimates for RCM. Revised budgets are prepared throughout the year in line with Department of Finance requirements for estimates review.

The accounting operations of the factories are decentralised, i.e. each factory prepares its own operational budgets and from them assesses the amount required from various appropriations such as RCM. These budgets and appropriation bids are then submitted to the controlling Division for further review and consolidation.

The bids are subject to further review by senior departmental management and Department of Defence. The Defence involvement stems from the fact that the expenditure is part of Defence outlay. Department of Finance also critically examines the bids as part of the budget process.

When the appropriation is decided each factory is given an allocation and is required to operate within it. Each factory has a prescribed officer and an authorising officer appointed under the Audit Act. The factory receives a commitment limit and warrant advice and is responsible for managing its allocation. There is regular reporting to Central Office of achievement against allocation and the Department of Finance IMS ledger system is structured to provide detailed information for each factory.



K. McROWN
Assistant Secretary
Finance & Property Branch

Organisation Charts and Functional Statements at Government
Aircraft Factories including:

Part 1 - GAF Organisation Chart

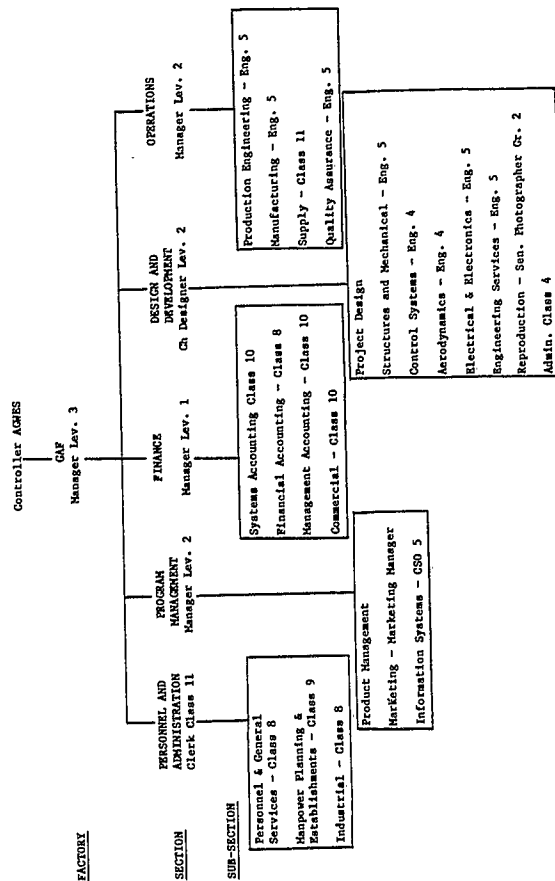
- Personnel and Administrative Section
- Program Management Section
- Finance Section
- Design and Development Section
- Operations Section

Part 2 - Diagrammatic Representation of Major
Major Involvement of Government Instrumentalities
in the Management of GAF

- Acquisition of Machinery and Plant
- Industrial Disputes
- Staffing

Annex B
Part 1

GOVERNMENT AIRCRAFT FACTORIES



PERSONNEL AND ADMINISTRATIVE SECTION - FUNCTIONAL STATEMENT

The Personnel and Administrative Section is responsible for the execution of all matters relating to the Factories' personnel and employment practices and for the Factories' administration and administrative services.

The functions of the Section include:

development of factory policy and related procedures covering personnel, industrial and establishment practices;

development of long and short term manpower plans to satisfy factory requirements and implementation of such plans;

planning and direction of employee/staff training programs having regard to the present and future needs of both the establishment and the individual;

administration of conditions of employment, pay, allowances, leave, incentive schemes etc. and the maintenance and promulgation of related procedures and regulations;

encouragement of good industrial relations and promotion of the best features of industrial democracy within the Factories, education of sub-ordinate and other staff in the maintenance of a harmonious and productive industrial climate;

participation in industrial negotiations with unions and staff associations;

continuous review of the organisation to ensure the best use of human resources and the achievement of factory plans and objectives;

development and establishment of personal welfare services for all members of the Factories' work force;

the maintenance of high standards of working conditions throughout the Factories (health, safety, heating, ventilation, lighting etc.);

maintenance of administrative services of high standard throughout the Factories.

PROGRAM MANAGEMENT SECTION - FUNCTIONAL STATEMENT

The Program Management Section is responsible for the continued acquisition of new work, including contract negotiation and funding, and the application of project management techniques over all current work within the factory to ensure satisfaction of contractual obligations.

The functions of the Section include:

ensure that the factory satisfies agreed customer requirements of cost, quality and delivery through the application of project management of tasks assigned to functional areas, negotiate on specification of work and placement of contracts, ensure availability of project funding;

plan long term business strategies and propose new lines of factory business, initiate action on long term changes to capacity and facilities;

control product specification, performance and cost through the application of configuration management to factory projects;

facilitate internal control through the provision of work package and project budget information and accurate and timely overhead recovery forecasts;

provide information services to all areas of the Factory, ensure that information systems are effective and meet user requirements, ensure effective operation of factory computer installation;

plan marketing and product support strategies for factory products;

monitor performance of distributors carrying out local marketing in defined regions, determine customer needs in chosen market sectors;

promote factory products on a world-wide basis.

FINANCE SECTION - FUNCTIONAL STATEMENT

The Finance Section is responsible for the maintenance of sound financial practice within the Factories and the provision of expert advice to the General Manager on financial policy, and support to both the project and functional organisations by the supply of timely and accurate cost information and financial guidance. The Section is responsible also for formal accounting activities, provision and control of funds and maintenance of finance services for the Factories as a whole.

The functions of the Section include:

establishment of general financial policy and the administration of financial accounting practice in accordance with requirements of Finance Regulations and Directions, Departmental policies and sound commercial practice;

co-ordination, preparation and recommendation for approval of capital and trading budgets and the direction of funding arrangements;

control of product costing and administration of the collection, recording, analysis and distribution of cost information;

development of product pricing policies and contractual conditions relating to funding, payment and cost escalation;

control of factory overheads and the implementation of necessary control procedures;

support to program management of all projects in the Factories;

control of cash flows, and administration of accounts, wages preparation, and budgets.

DESIGN AND DEVELOPMENT SECTION - FUNCTIONAL STATEMENT

The Design and Development Section is responsible for the design and development of new aircraft and guided weapons systems in response to service requirements or market demands and the provision of post-design engineering support to users and to other functional areas of the Factories.

The functions of the Section include:

develop feasible and economic configuration in response to approved aircraft and guided weapons design enquiries;

design and develop selected configuration of aircraft, guided weapons and related systems through to testing and type certification;

undertake major redesign of basic aircraft or guided weapons types to meet changing service or civil user requirements;

provide engineering support to local design and production projects during the service life of the aircraft, weapon or equipment;

provide specialist engineering expertise to the services as requested and to other Departments and authorities as approved.

OPERATIONS SECTION - FUNCTIONAL STATEMENT

The Operations Section is responsible for the manufacture of aerospace products to furnished designs, within cost and delivery quotations and to acceptable quality standards. It also has responsibility for maintenance of production capability and capacity, both internal and external, to suit predicted factory work trends.

The functions of the Section include:

provide estimates of cost and delivery for the production and procurement content of assigned enquiries;

plan for production and procurement of items of furnished designs within project master plans and schedules;

produce and/or procure goods to defined technical specifications and within cost and schedule authorizations;

Introduce and maintain effective production technology;

obtain, instal, and maintain tooling, plant and equipment in support of factory tasks, provide and maintain buildings and services within the factory area;

develop, utilize and maintain internal and external resource capabilities and capacities in support of production workload;

maintain adequate control over the quality and reliability of factory products, continually explore avenues for improved methods of assuring quality;

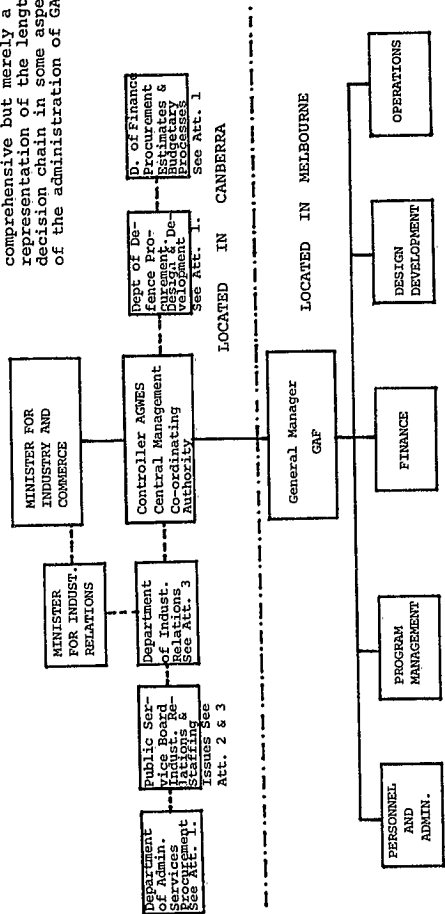
undertake developmental, certification and production flight testing and demonstration flying of Government Aircraft Factories' projects.

ANNEX B

PART 2

DIAGRAMATIC REPRESENTATION OF MAJOR INVOLVEMENT OF GOVERNMENT
INSTRUMENTALITIES IN THE MANAGEMENT OF GAF

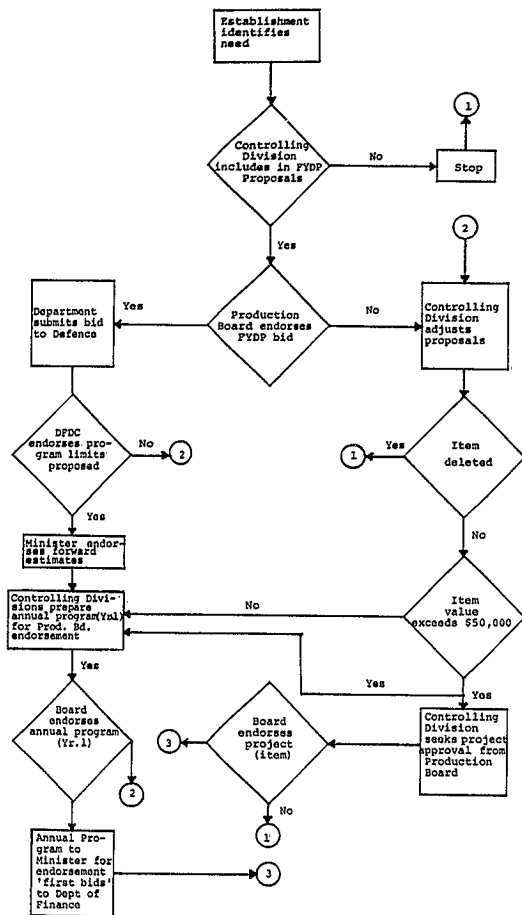
N.B. This diagram is not meant to be comprehensive but merely a representation of the length of decision chain in some aspects of the administration of GAF.



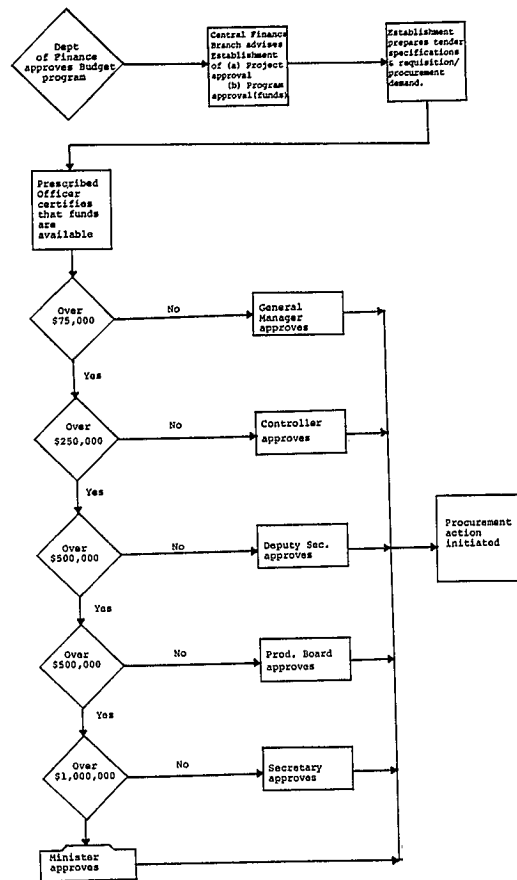
ACQUISITION OF MACHINERY AND PLANT

The acquisition of capital equipment at GAF is a lengthy and time consuming process. Set out overleaf is a flow chart of procedures the General Manager GAF must go through. The Department states that this process on average can take up to eighteen months. Once these procedures are complete the Department must then liaise with the Department of Administrative Services as the central procurement authority for the Commonwealth, involving even further delays.

PROJECT/PROGRAM APPROVAL



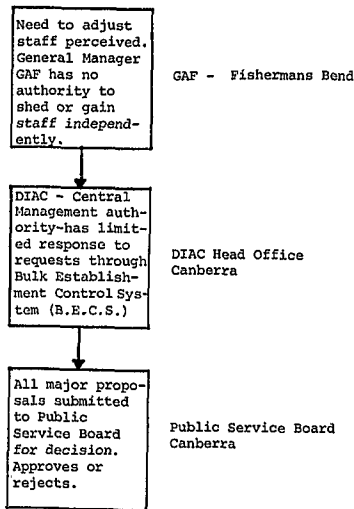
APPROVAL OF EXPENDITURE



STAFFING

ATTACHMENT 2

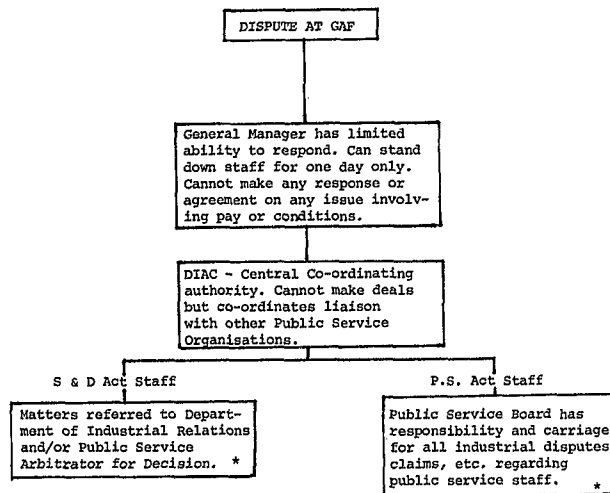
From time to time, because of the fluctuating nature of the workload at GAF, the General Manager may wish to adjust his staffing levels. Theoretically, under the Supply and Development Act, he has authority to Adjust S & D Act Staff but this is rarely if ever exercised. For P.S. Act staff, rules governing P.S. Act employment apply. Set out below is a simplified flow chart of departmental procedures to alter staffing. Both S & D and P.S. Act Staff at GAF are subject to departmental and overall Public Service ceilings. Staffing in excess at requirement for correct workload is a charge to RCM.



ATTACHMENT 3

INDUSTRIAL DISPUTES

In the resolution of Industrial disputes, the General Manager GAF has only limited ability to respond independently. He is unable to make a decision on any issues involving salaries, wages or conditions. He has authority to stand staff down for one day at a time only. Set out below is a simplified flow chart of procedures for the resolution of industrial disputes:



* With both categories of staff, Public Service industrial and related legislation applies. (CERR, CEEP, etc).

FINAL REPORT TO
THE TREASURER, THE MINISTER FOR DEFENCE
AND THE MINISTER FOR PRODUCTIVITY
BY THE WORKING PARTY

ON

THE ACCOUNTING ARRANGEMENTS AND FINANCIAL
STATEMENTS OF THE UNDERTAKINGS CONTROLLED
BY THE DEPARTMENT OF PRODUCTIVITY

NOVEMBER 1976

COMPOSITION OF WORKING PARTY

Members:

Department of the Treasury	Mr D.J. Sinclair (Chairman)
Department of Defence	Mr J.R. Bennett
Department of Productivity	Mr M.T. Hyland
	Mr K. McKnown

Observer:

Auditor-General's Office	Mr E.J. Donnelly
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Attachments:-

Annex A: First and Second Interim Reports to Ministers

Annex B: Financial Statements applicable to the Government Aircraft Factories (GAF) and the Australian Government Clothing Factory (AGCF)

Annex C: Financial Statements applicable to the Munitions Factories

Annex D: Method of Calculation of Defence Munitions Man-hour Rate (DMMR)

Annex E: List of Undertakings Controlled by the Department of Productivity.

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

PRESENT ACCOUNTING SYSTEM

- The Working Party concludes that the present accounting system adequately meets the needs of the Department and factory managements for management accounting information and statutory accounting requirements under the Supply and Development Regulations (paragraph 8).

COSTING BASIS

- The working Party recommends that the Government Aircraft Factories, the Australian Government Clothing Factory, and the Australian Government Engine Works continue for the time being to use the "Normal" level of production costing basis pending resolution of certain external considerations affecting these factories (paras 15-16).

NOTE: The Working Party has not found it necessary to recommend with regard to the Munitions Factories because of the recent introduction of the Defence Munitions Manhour Rate (DMMR) approved for use in these factories from 1 Jun 1976 (paras 19-23).

PRICING POLICY

- The Working Party recommends the following pricing policies:-

(a)

For application to -

- (i) Service orders on the Government Aircraft Factories and the Clothing Factory; and
- (ii) at all factories, work chargeable to the Defence Outlay through Department of Productivity Appropriations,

the recovery of cash costs of direct labour, direct materials, sub-contract and other direct costs, plus fixed and variable cash overheads at rates based on normal capacity.

NOTE: A recommendation for Service orders on the munitions factories is not necessary in view of the recently introduced charging policy associated with the DMMR - this provides for recovery of direct costs only (labour (plus personal overheads) and materials, sub-contract and other direct costs (paragraph 21)).

(b)

For application at all factories, for other customers - when the work is taking up capacity which would otherwise be unused, the recovery of at least the following, subject to the proviso that higher prices are always charged where these can be borne by the market:

- (i) labour costed at the direct manhour rate such rate being the cash cost of direct labour plus a calculated allowance to recover variable overheads;
- (ii) a loading of 15% on labour costed at the direct manhour rate to cover non-cash costs such as superannuation, interest on capital etc;
- (iii) the cash costs of direct materials;
- (iv) the cash costs of direct expenses not covered by the allowance for variable overheads. An example of direct expense would be travel specially undertaken for the execution of a customer's order; and
- (v) an element to amortise, over the expected production, the cost of plant and production development specifically incurred as a result of accepting an order. (Paragraph 18.)

FINANCIAL STATEMENTS

- The Working Party recommends that the format of the financial statements at Annex B be adopted for use at both the Government Aircraft Factories and the Clothing Factory, and that those at Annex C be adopted for use at the munitions factories utilising the DMMR, for reporting on their activities (paragraph 28).

• The Working Party recommends that subject to any unforeseen problems that may arise at individual factories, the new formats be applied to the trading results for the year ending May 1977 (paragraph 29).

NOTIONAL COSTS

• The Working Party recommends:

- (a) the costs of services/facilities provided to the factories and such non-cash costs as depreciation, interest, insurance, etc be shown in the factories financial statements on a notional basis;
- (b) the notional costs of administrative support should be calculated for each factory as a percentage of the total factory costs for that factory;
- (c) it would be appropriate for the initial percentage factor to be based on the support costs already gathered for all the factories as a by-product of the pilot studies together with some further details being ascertained; and
- (d) a review of the percentages for each factory to be undertaken periodically, say each three (3) years (paragraph 34).

AUDIT

- The Working Party believes that it should now be possible to progress much earlier than had previously

been contemplated to the point where the Auditor-General can give an unqualified report on the financial statements (paragraph 36).

JOINT COMMITTEE OF PUBLIC ACCOUNTS

- . The Working Party concludes that preparation of the Statements at Annexes B and C will satisfy the pertinent qualifying conditions of the Joint Committee's 34th Report - with the possible exception of audit (paragraph 38).
- . The Working Party recommends that the factories' annual reports, accompanied by financial statements in the new formats, after review by the Board of Management for Production, be submitted to the Minister. It sees no impediment to the reports being tabled in Parliament (paragraph 39).

RESERVE CAPACITY MAINTENANCE

- . The Working Party concludes that the US system is not relevant to the Australian situation and that because of the high degree of under-utilisation of capacity at the Australian factories, the UK system is not appropriate at present (paragraphs 44-46).

FUNDING

- . The Working Party recommends that:
 - (a) the amounts required for maintenance of reserve capacity continue to be appropriated (paragraph 41); and

- (b) existing procedures for the appropriation of amounts required for working capital, plant and machinery, production development and assistance, etc, be continued (paragraph 51).

FINAL REPORT

BACKGROUND

On 24 Dec 1970, the then Treasurer wrote to the Minister for Supply (copies to the Minister for Defence and the Auditor-General) proposing that a Working Party be established to carry out an enquiry with the following terms of reference:-

"... to produce for us a report on the accounting arrangements for the defence production undertakings operated by your Department^(*). I envisage this report as covering costing and pricing practices, the treatment of reserve capacity maintenance, funding and, as containing recommendations directed towards early achievement of the aim stated in paragraph 14 of the attached submission to the Joint Committee of Public Accounts - namely, that of having the system of accounting and costing developed along lines which would enable compliance with the qualifying conditions proposed in paragraph 162 of the Committee's Thirty-fourth Report and accepted as guidelines in the Treasury Minute thereon, and which at the same time would provide the most satisfactory basis for policy and management decisions as to the pricing of the outputs of the undertakings, new investment in the undertakings and operation of them generally."

* Note - Annex E to this report lists the undertakings currently under the control of the Department of Productivity and covered by this report.

2. Representation on the Working Party has been provided by the Departments of the Treasury, Supply (now Productivity) and Defence. The Auditor-General's Office has been represented by an observer.

3. Two interim reports have been submitted to Ministers. The first was presented in September 1971 and the second in September 1974. Copies of these reports are attached as Annex A. In brief, the first report indicated that present records did not reflect the total cost of the undertakings to the Government, and that a need existed to reappraise the manner in which Government assistance is provided to the undertakings to maintain their capacity for quickly increasing production in the event of a war. Mention was made of the complex nature of many of the subjects to be examined by the Working Party.

4. The second interim report detailed some of the complexities involved in a full examination of this type. The position then reached was that the Working Party had:-

- (a) agreed on the pricing policy to be adopted;
- (b) agreed in principle on the form of financial statements to be produced by each factory but proposed that these statements would not be certified or reported on by the Auditor-General initially although they would be made available to him for any comment he wished to make;
- (c) proposed that appropriations would still be required for reserve capacity maintenance, additional working capital, plant and machinery etc; and

- (d) supported in principle the concept of the Practical Capacity level of production as the costing base (refer paragraph 11) but noted further investigation would be required before its adoption could be recommended.

SIGNIFICANT DEVELOPMENTS SUBSEQUENT TO SECOND INTERIM REPORT

5. The Working Party initiated pilot studies of 12 months duration at the Ordnance Factory, Maribyrnong and the Munitions Filling Factory, St Mary's, to test certain of its proposals, viz, Practical Capacity costing, and to assess the adequacy of the format of the proposed financial statements. Costs not presently included in factory statements, eg, depreciation, interest on working capital, administrative support provided by other departments, were included notionally in the statements. The studies concluded in May 1976, having been run to coincide with the factories' accounting periods. Comment on the trials appears later in this report.

6. As a result of concern over the declining work load available to Government Munitions Factories, certain changes were introduced towards the end of the pilot studies that supplanted Working Party proposals concerning a costing basis - the Practical Capacity concept - and a pricing policy for these factories. These changes involved the establishment of a "Critical Labour Level" (CLL) for each factory - that is the minimum labour level required in the munitions factories to maintain a core defence production capability - and the subsequent introduction of a special Defence Munitions Man-hour Rate (DMMR) to be charged by the munitions factories for Service work. Further details are given at paragraphs 19 to 23.

THE ACCOUNTING SYSTEM

7. The Working Party examined the accounting procedures, financial statements and the accounting manuals of defence production undertakings of the then Department of Industry and Commerce and noted the provisions of Supply and Development Regulation 13, which states:-

"Subject to the Audit Act 1901-1973 and the regulations made thereunder, the Secretary shall be responsible for and determine the accounting methods and practice to be adopted and observed by all officers in relation to the accounts and business of the Department, the Boards and the undertakings established or deemed to have been established under the Act."

8. The Working Party observed that the Department's factories operated a uniform accounting system that provided cost records which were integrated and reconciled with the financial accounts, and concluded that the system adequately meets the needs of the Department and factory managements for management accounting information and statutory accounting requirements under the Supply and Development Regulations. Annual financial statements are prepared and submitted to the Board of Management for Production but these statements are not certified by the Auditor-General and the operating statements bring to account transactions through each Factory Trust Account only, thus excluding non-cash costs such as superannuation, interest on capital and support services now provided without charge to the factories, eg, legal, health etc. The Balance Sheet records capital items such as Plant and Machinery provided by appropriations.

COSTING/PRICING BASES

9. Costing: The costing procedures and pricing policies of the undertakings make allowance for the fact that the levels of defence production capability, and therefore the facilities and skills these undertakings are required to maintain, are in excess of those required for peace time production. The additional costs of this excess capacity are met from the appropriation item "Reserve Capacity Maintenance - Government Factories".

10. For many years the costing system of the (now) Department of Productivity has been based on a "Normal" level of production during peacetime in accordance with the criterion of full employment on a single shift basis. "Normal Level of Production" is defined as:-

"A level of plant activity expressed in terms of standard labour hours, appropriate to the number of employees or volume of production accepted by management as "normal"."

11. The Working Party found that overhead rates calculated on the basis of "Normal Capacity" tended to exceed those used in commerce because the latter do not incur overheads in respect of excess capacity - ie commercial organisations are free to reduce plant and personnel in response to changes in the market place. The Working Party investigated modifications to the concept of the Normal level of production in an effort to overcome this problem but found that only marginal improvement could be obtained. An investigation of an alternative costing basis, the Practical Capacity level was then made. The Practical Capacity level is described, again in terms of a single shift, as:-

- (a) all machines operating to the maximum extent intended for each machine or production line, as appropriate;
- (b) all personnel needed to operate the machines in the above manner present and working; and
- (c) allowances to be made for non-productive time and leave of direct labour, and machine repair and maintenance.

12. In its second report the Working Party supported the adoption of the Practical Capacity level of production as the costing base because the Practical Capacity level could more precisely be defined, would be easier to compute, would give a better measure of the extent of unused capacity and would be less subjective than Normal Capacity levels which have been somewhat difficult to assess and justify in the past. Additionally, products cost would be lower, hopefully attracting additional workload to the factory.

13. However, the Working Party considered that further investigation of the Practical Capacity concept was required before its adoption could be recommended. To this end pilot studies to enable assessment of the effects of changing, for costing purposes, from the Normal to the Practical Capacity level of production were undertaken at the Ordnance Factory, Maribyrnong and the Munitions Filling Factory, St Mary's, during the factories' 1975-76 financial year.

14. Review of the trial revealed that calculation of Practical Capacity for each factory was achieved satisfactorily and confirmed that it was in fact easier to determine than Normal Capacity. The extent to which the application of the Practical Capacity concept had been

successful in attracting additional Service orders was unable to be assessed with any reasonable degree of accuracy due primarily to variations in ordering patterns arising from budgetary uncertainties during the "Supply" period and economic constraints during the subsequent period of the trial.

15. Notwithstanding these problems the Working Party considers that the trial demonstrated that Practical Capacity costing is an acceptable costing basis and, but for the events indicated at paragraph 6, would have recommended its adoption into the munitions factories in lieu of "Normal Capacity".

16. With this in mind the Working Party then considered whether the Practical Capacity concept should be applied to the remaining factories, viz, the Government Aircraft Factories (GAF), the Australian Government Clothing Factory (AGCF) and the Australian Government Engine Works (AGEW). For the following reasons the Working Party recommends that these factories continue for the time being to use Normal Capacity costing:-

- (a) AGEW - Negotiations for the disposal of this facility are currently being undertaken by the Department of Administrative Services. In these circumstances a change of costing base from Normal Capacity would not be appropriate.
- (b) GAF - Consistent with its conclusions on the benefits of Practical Capacity over Normal Capacity, the Working Party saw merit in the application of the Practical Capacity concept to the GAF. However, the Working Party noted that other external factors presently had a bearing on this question. It had in

mind current interdepartmental committee considerations on whether GAF should become a statutory authority and that, in conjunction with concurrent considerations on rationalisation of facilities at GAF, there was to be a review of accounting arrangements, including the operation of the reserve capacity maintenance scheme to apply to the three major contractors in the domestic defence aerospace industry (Government Aircraft Factories, Commonwealth Aircraft Corporation and Hawker de Havilland). Notwithstanding its attraction to the Practical Capacity concept, the Working Party concludes that pending the outcome of these matters the GAF should continue to utilise the Normal Capacity costing basis.

- (c) AGCF - The factory enjoys a high and continuing workload with little reserve capacity maintenance although there are occasional pockets of under-employment, eg, the embroidery section. In these circumstances the Working Party saw little real advantage in adopting Practical Capacity bearing in mind that one of the benefits expected of Practical Capacity - the attraction of Service orders which otherwise might be placed elsewhere on grounds of apparent cost - is not particularly relevant to the Clothing Factory. Additionally, the Working Party was informed that Service supply authorities are required by the Department of Defence to give first consideration to placement of clothing orders with the Clothing Factory.

The Working Party also noted that, for the present at least, utilisation of Practical Capacity at the Clothing Factory would mean that this factory would be the only one so operating. While this in itself

was not regarded as a valid reason for maintaining the status quo, it was felt that in view of the present comfortable workload situation at this factory and external considerations affecting the GAF and the other major contractors in the aircraft industry, a departure from the Normal Capacity basis of costing at the Clothing Factory at this time would not be warranted.

17. Pricing: The second interim report to Ministers also indicated that a pricing policy had been agreed by the Working Party which recommended:-

- (a) for Service orders, the recovery of cash costs of direct labour and direct materials plus fixed and variable cash overheads allocated by the costing system adopted; and
- (b) for other customers, when the work is taking up capacity which would otherwise be unused, the recovery of at least the following, subject to the proviso that higher prices are always charged where these can be borne by the market:
 - (i) labour costed at the direct manhour rate such rate being the cash cost of direct labour plus a calculated allowance to recover variable overheads;
 - (ii) a loading of 15% on labour costed at the direct manhour rate to cover non-cash costs such as superannuation, interest on capital etc;
 - (iii) the cash costs of direct materials;

(iv) the cash costs of direct expenses not covered by the allowance for variable overheads. An example of direct expense would be travel specially undertaken for the execution of a customer's order; and

(iv) an element to amortise, over the expected production, the cost of plant and production development specifically incurred as a result of accepting an order.

18. The recommendation at paragraph 17(a) has, of course, been supplanted with regard to the 8 Munitions factories by the adoption of the Defence Munitions Man-hour Rate (DMMR); however, it remains applicable to the Government Aircraft Factories and the Australian Government Clothing Factory. Under the agreed arrangements for the introduction of DMMR, there is to be no change in the basis of charging to Defence for Department of Productivity (DOP) work chargeable to Defence Outlay through DOP appropriations. Thus, the pricing basis in paragraph 17(a) applies also to this work. The recommendation in 17(b) is not affected by adoption of the DMMR rate and remains applicable to all factories.

DEFENCE MUNITIONS MAN-HOUR RATE (DMMR)

19. As indicated earlier - paragraph 6 - there have been developments in recent months that have affected quite significantly the work done by the Working Party. The Critical Labour Level (CLL), which is a major factor in determining the inescapable cost of maintaining the munitions factories, is presently an interim assessment only pending the outcome of a Department of Defence/Department of

Productivity study of core defence capability requirements in the munitions factories. In order to utilise the factories as economically as practicable at the CLU, a variation in the method of charging the Services was introduced, designed to attract Service orders which otherwise might be placed elsewhere on grounds of apparent cost. The Services have sought to stretch their Equipment and Stores appropriations as far as possible which has meant they have opted to purchase elsewhere if factory charges for equivalent goods have been dearer. However, because the factories have had to be maintained from within the total Defence outlay whether or not any orders were placed with them, the effect has been that whilst the Services' appropriations have benefitted from orders placed elsewhere, the overall cost to the Defence budget of many of the orders has been greater than if the orders were placed with the factories.

20. The determination of an appropriate basis for charging for Service orders was made by the Treasurer and the Ministers for Industry and Commerce and Defence who subsequently agreed to the application of the Defence Munitions Man-hour Rate (DMMR) for Service orders placed on the eight munitions factories and to a basis for the calculation of this rate with effect from the start of the factories' 1976-77 financial year.

21. This agreement enables Service orders to be costed on the basis of direct costs only - labour (plus personal overheads) and materials, sub-contract and other direct costs. These costs are to be met from the respective Defence appropriations. All other costs associated with factory operations and maintenance, such as indirect labour, salaried staff, indirect materials etc are to be classified as overheads and charged to the item "Reserve Capacity Maintenance - Government Factories" under the Department of Productivity.

22. The direct labour charge (DMMR) will remain firm for the whole financial year and be calculated on prices and wage rates in existence at the commencement of that financial year. Appropriate adjustments are to be made for orders extending beyond the end of a financial year when a revised man-hour rate will apply. This will enable cash requirements for the respective Defence appropriations to be estimated more accurately and reduce considerably the administrative burden involved in retrospective adjustment of costings to take account of increases in man-hour rates. A copy of the method of calculation of the Defence Munitions Man-hour Rate is attached at Annex D.

23. The introduction of these new arrangements is subject to close monitoring of the effect on Service ordering patterns and to further interdepartmental review and report to Ministers before the end of the 1976-77 fiscal year.

FINANCIAL STATEMENTS

24. Prior to submission of the second report to Ministers, the Working Party had devised a form of financial statements to be used by the factories comprising a Statement of Assets and Liabilities and a Memorandum Trading Statement. These financial statements were used to present the results of the pilot studies.

25. The Trading Statement makes provision for the inclusion of all costs, the omission of which had been criticised by the Auditor-General. The notes to the Statement provide the breakup of overheads into amounts charged to current production and the reserve capacity appropriation; an analysis of variances; any profit or

loss made (based on prices charged and costs allocated under the adopted costing system); and explanations of items such as depreciation and interest which are shown as notional expenses, matched by notional income, pending settlement of policy on interdepartmental payments.

26. The Working Party considers that subject to several minor amendments the financial statements as used in the pilot studies are satisfactory. Copies of these statements containing the necessary amendments are attached at Annex B.

27. Whilst the statements at Annex B are adequate and appropriate for application to the Government Aircraft Factory and the Clothing Factory, the advent of the Defence Munitions Man-hour Rate - see paragraphs 19 to 23 - has however necessitated changes to the Trading statement as far as the munitions factories are concerned. These changes are necessary in order to adequately disclose the cost of sales based on the pricing policy inherent in application of the DMMR as well as the cost of maintaining production capacity - as provided for in the appropriation "Maintenance of Production Capacity". A sample of the formats to be used for the munitions factories is attached at Annex C to this report.

28. The Working Party recommends that the statements at Annex B be adopted for use at both the Government Aircraft Factories and the Clothing Factory, and that those at Annex C be adopted for use at the munitions factories utilising the DMMR.

29. The Working Party further recommends that subject to any unforeseen problems that may arise at individual factories, the new formats be applied to the trading results for the year ending May 1977. In this context the Working

Party noted that the additional costs of introducing the new format at the Ordnance Factory, Maribyrnong and the Munitions Filling Factory, St Mary's were marginal as the additional workload was absorbed by existing staff.

30. It is important to note that in commenting on the financial statements prepared as a result of the pilot studies the Auditor-General's office indicated that while it was in agreement with the form and content of the Statement of Assets and Liabilities, and Memorandum Trading Statement adequately supported by the Notes thereto, one possible area of difficulty is the assessment of the accuracy of support costs. This would probably involve in-depth examination of the bases used by departments.

NOTIONAL COSTS

31. A past criticism of the factories accounts has been that they did not include all costs incurred by the Commonwealth Government in the operation and maintenance of the factories.

32. In regard to the Audit Office comment, paragraph 30, the Working Party in its second report to Ministers had indicated it expected some difficulty in obtaining satisfactory estimates of administrative support costs. This formed the basis of the proposal that the first few annual statements, whilst being made available to the Auditor-General for any comment he may wish to make, would not be certified or reported on by him. The Working Party felt then that the most practical course of action would be a gradual progression to the point when the Auditor-General could give an unqualified opinion on the financial statements.

33. The Working Party considers that the inclusion in the financial statements at Annexes B and C, on a notional basis, of non-cash costs such as depreciation, interest on capital, superannuation, insurance, as well as the cost of administrative support provided by Commonwealth Departments but not presently charged against the factories, overcomes the past criticism. The pilot studies illustrated the benefit of disclosure of such costs in that they highlighted what previously had been a substantial "hidden" cost.

34. Following experience over the pilot study period and further investigations the Working Party believes it has identified the significant costs of the administrative support provided to the factories from Commonwealth sources. Recognising that there are some forms of administrative support that could not be costed with any degree of accuracy (such as support from the Public Service Board and the Treasury) and that in any event it would not be cost effective to endeavour to establish and cost an exhaustive level of support, the Working Party has concluded, and recommends accordingly, that:-

- (a) The costs of services/facilities provided to the factories and such non-cash costs as depreciation, interest, insurance, etc be shown in the factories' annual financial statements on a notional basis;
- (b) the notional costs of administrative support should be calculated for each factory as a percentage of the total operating costs for that factory;

- (c) it would be appropriate for the initial percentage factor to be based on the support costs already gathered for all the factories as a by-product of the pilot studies together with some further details being ascertained; and

- (d) a review of the percentages for each factory to be undertaken periodically, say each three (3) years.

35. The Working Party noted that the matter of charging by Government departments for work performed by them on behalf of another is currently under review. Should a system of interdepartmental chargings be instituted, then the necessity to assess some of the costs now indicated on a "notional" basis would no longer apply.

36. The Working Party is now of the view that if the arrangements in paragraph 34 are implemented, it should be possible to progress to the point where the Auditor-General can give an unqualified report on the financial statements of the production undertakings much earlier than had been contemplated in the second report to Ministers in September 1974. It understands that the Treasury will now discuss this matter further with the Auditor-General's office with a view to resolving it in the near future.

COMPLIANCE WITH THE QUALIFYING CONDITIONS PROPOSED BY THE JOINT COMMITTEE OF PUBLIC ACCOUNTS IN ITS THIRTY-FOURTH REPORT

37. The following are the qualifying conditions proposed by the Joint Committee of Public Accounts at paragraph 162 of its Thirty-fourth report:-

"162. Your Committee consider that in many cases, trust accounts in the nature of working accounts have distinct advantages over the system of annual appropriations. We think that a number of qualifying conditions should normally be complied with both before such accounts are established, and in connexion with their operation:-

- (i) There should be a policy decision that the body in question (normally it could appropriately be termed an "undertaking") is to operate on a quasi-autonomous basis (we have already referred to this matter in our Report on the Canberra Abattoir); and we place strong emphasis, in this context, on the word "operate". In our view, it connotes the day-to-day activities of the organization, activities that in a Department are generally subject to the direction of the Minister; but which in these organisations are usually not so: they operate only subject to general directives as the ends to be achieved.
- (ii) There should be an obligation upon the undertaking to keep a Profit and Loss Account, and a Balance-sheet, and in other ways to operate on the basis that its incomings should match its outgoings (subject, of course, to any policy direction about the level of profit or subsidy involved; and the "subsidy", where needed, should be shown as such in the Estimates and should be kept distinct from capitalization measures, which should be shown in the Capital Works and Services section of the Estimates).

- (iii) The annual Profit and Loss Account and Balance-Sheet should be certified by the Auditor-General.
- (iv) The working advance representing the appropriation to the trust account should be determined at a level that would facilitate the efficient operation of the undertaking; but not at a level such as would enable it to branch out, without appropriate directives and additional advances, into new fields of activity.
- (v) Unless policy requirements are expressly to the contrary, the undertaking should prepare annual reports. Preferably these should be made to the Parliament; but there may be occasions when report to the responsible Minister would be adequate. We would think inappropriate any lesser obligation than that of annual report to the Minister.
- (vi) A regular review of the level of the Advance should be made by the appropriate authorities (which, we consider, include both the Auditor-General and the Treasurer) in order to ensure that it is not larger than is essential for the efficient operation of the undertaking.
- (vii) In any event, the Budget papers should include, along the lines discussed in Chapter III above, information concerning the balance, level of advance and purposes of the account."

38. The Working Party considers that preparation of the statements at Annexes B and C of this report will satisfy the qualifying conditions proposed by the Joint Committee of Public Accounts with the possible exception of the condition concerning audit. The Working Party considers that the statements can be developed at an early date to overcome that exception (para 36 refers).

39. The Joint Committee suggested that annual reports be submitted to the Minister and possibly Parliament, and that Budget papers should include information concerning the balance, level of advance and purposes of the account. The Working Party recommends that the factories' annual reports accompanied by financial statements prepared in the new formats at Annexes B and C, after review by the Board of Management for Production, be submitted to the Minister. The Working Party sees no impediment to such reports being tabled in Parliament. It also notes that the Treasurer's Statement of Receipts and Expenditure now provides the data which the Joint Committee requested be included in the Budget papers.

40. The Working Party's comments on conditions (iv) and (vi) are in paragraph 47.

RESERVE CAPACITY MAINTENANCE AND FUNDING ARRANGEMENTS

41. The Working Party recommends that the amounts required for maintenance of reserve capacity continue to be appropriated. It has been agreed between Treasury and the Department of Industry and Commerce (now Productivity) to include each year, in the departmental explanatory notes in support of the annual estimates, an estimate of expected

production hours, a dissection to show the expected amounts for subsidy and profits or losses, plus in the case of the munitions factories, the cost of surplus staff at the Critical Labour level.

42. For the eight (8) Munitions factories at which the DMMR applies, the method of determining the charge for reserve capacity maintenance has been explained at paragraph 21. As regards the method of determining reserve capacity for the Clothing Factory and the Aircraft Factories, there would be no change under the recommendation made in paragraph 16.

43. In the course of its enquiries the Working Party examined the practices followed by the United States and the United Kingdom Governments in the treatment of excess capacity.

44. Preliminary examination of the US situation indicated that there was little similarity - both in operation and policy - with that in Australia, primarily because of the availability of commercial manufacturing organisations and of the US approach of involving private industry to the largest extent possible - including maintaining reserve capacity in private industry. In the circumstances the Working Party decided that the US system was not relevant to the Australian situation.

45. The situation of the UK Ordnance Factories differs significantly from that of the Government undertakings in Australia. The Royal Ordnance Factories (ROF's) are able to obtain a very high proportion of their turnover from overseas customers, for example for the 9 months ended

31 Mar 1975, sales totalled £82 million of which £44 million (£53.64) related to the United Kingdom and £38 million to overseas. Sales within the UK would also include commercial customers. The current philosophy behind the UK approach to reserve capacity is that it should not include any manpower costs other than necessary costs in care and maintenance of any under-utilised buildings and machinery. Under-utilisation is now very small and in some cases non-existent because of the success of the policy of looking and competing for private business. Where a reduced reserve capacity in assets is maintained for emergency purposes, the cost of that capacity is understood to be, in the main, insignificant. A reserve capacity payment is made from a Ministry of Defence appropriation but it is not shown separately in the accounts of the ROP's; it is included in the sales figure.

46. As regards the Australian factories, the Working Party notes that determined efforts have been made, with limited success, to promote the sale of products of the factories and to attract additional work from non-defence sources but that it is unlikely both in the short term and for the foreseeable future that the defence factories could attain a level of utilisation approaching that experienced by the ROP's. The Working Party concluded that because of the high degree of under-utilisation of capacity at the Australian factories, the UK system is not appropriate at present. Should this position alter as a result of increased workload and/or a reduced level of factory capacity required for essential defence purposes (eg, as a result of the study mentioned at paragraph 19) the position may need to be reviewed again.

47. Other Funding Arrangements: Each of the factories is provided with a revolving-type trust account to finance the day-to-day operations of the factory. Each trust account is provided with a working capital advance. Arrangements have been made for the level of working capital in each undertaking to be reviewed by the Treasury annually, in the Estimates context, with additional advances or repayments to Revenue being agreed. More frequent reviews are conducted, as required, by the Department of Productivity. Arrangements for temporary repayable advances, to meet peak or unforeseen developments, can be made at any time during the year, provided of course that the requirement is essential.

48. Each factory Trust Account has identical defined purposes viz "Payment for goods and of salaries, wages and all other expenses incurred in connection with the operations of the factory for the production of war material and other production approved by the Minister".

49. In addition to the Factory Trust Accounts there is a central account titled Munitions Production Trust Account with the following defined purposes:-

"To finance:-

- (a) the manufacture of munitions in Government factories, annexes and industry for Departments of the Australian Government and other Governments and Authorities; and
- (b) any other approved service of a munitions factory or annexe."

This latter Trust Account is virtually a clearing account for most orders on the Department, many of which are in turn placed on industry and factories. The account pays monthly progress claims by the factories and industry and obtains recoupment from customers.

50. The Working Party notes that there is a proposal currently under consideration by Treasury and the Department of Productivity for the amalgamation of the Munitions Production Trust Account and the individual factory Trust Accounts with a view to improving administrative procedures. The Working Party observed that the introduction of a DMMR at the munitions factories, with all indirect expenses chargeable to reserve capacity maintenance, can be expected to permit a reduction in working capital levels and understands that this matter is also under examination by the appropriate authorities.

51. The Working Party has also reviewed other funding arrangements eg for plant and machinery, production development and assistance. It was noted that, consistent with the need for adequate disclosure and scrutiny of expenditures, sums to be expended on these categories are included under specific headings in the Appropriation Bills and are subject to examination in the normal manner as part of departmental estimates. In these circumstances the Working Party sees no reason to disturb the present arrangements, and recommends that existing procedures for the appropriation of amounts required for working capital, plant and machinery, production development and assistance, etc, be continued.

(sgd) D.J. Sinclair

D.J. SINCLAIR

Treasury (Chairman)

(sgd) K. McKnown

K. MCKNOWN

Department of Productivity

(sgd) J.R. Bennett

J.R. BENNETT

Treasury

25 NOVEMBER 1976

(sgd) M. Woolley

for M.T. HYLAND

Department of Defence

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APPROVED FORM OF ACCOUNTS

GOVERNMENT AIRCRAFT FACTORIES

I, DOUGLAS JOHN HILL, First Assistant Secretary, Accounting and Supply Division, Department of Finance, in exercise of powers under Section 41D of the Audit Act 1901 delegated to me by the Minister of Finance, DO HEREBY REQUIRE the Department of Productivity to prepare financial statements, substantially in the form of the schedule attached hereto, in respect of the operations of the Aircraft Engineering Workshop, Pooraka, SA, the Australian Government Clothing Factory and the Government Aircraft Factories.

DATED this 20th day of June 1979


D.J. Hill

MEMORANDUM TRADING STATEMENT FOR YEAR ENDED

		19...	19...
	Notes	\$	\$
FACTORY OPERATING COSTS			
Cost of Production	2		
Direct labour (... manhours)	.....	.....	.....
Direct material	.....	.....	.....
Sub-contract work	.....	.....	.....
Other direct expenses	.....	.....	.....
Total Cost of Production		.....	.....
Reserve Capacity Cost	3-8	.....	.....
Total Factory Operating Costs		.....	.....
NOTIONAL OPERATING COSTS			
Audit fees	9	.....	.....
Administrative support	10	.....	.....
Depreciation	11	.....	.....
Interest on capital	12	.....	.....
Superannuation	13	.....	.....
Repairs and maintenance	14	.....	.....
Insurance	15	.....	.....
Other expenses	16	.....	.....
Total Notional Operating Costs		.....	.....
NON-OPERATING EXPENSES	17	.....	.....
EXTRAORDINARY EXPENSES	18	.....	.....
TOTAL COST OF OPERATION AND RETENTION OF FACTORY		.....	.....

	19...-		19...-	
Notes	\$	\$	\$	\$
<u>LESS INCOME:</u>				
OPERATING INCOME				
Sales				
Defence customers	.....		.....
Overseas customers	.....		.....
Commercial customers	.....		.....
Department of Productivity	.....		.....
Total Operating Income	.....		.....
NON-OPERATING INCOME	19	.....	.....
EXTRAORDINARY INCOME	20	.....	.....
INCREASE/DECREASE IN:	21			
Net work-in-progress	.....		.....
Stock of finished goods	.....		.....
TOTAL INCOME		.....	.....
NET COST OF OPERATION AND				
RETENTION OF FACTORY		=====	=====	
This cost is met by:				
Factory Cost Subsidy	3-3	.....	.....
Notional Cost Subsidy (contra				
to Notional Operating Costs)		.....	.....
GOVERNMENT COST OF OPERATION AND				
RETENTION OF FACTORY		=====	=====	

MEMORANDUM STATEMENT OF ASSETS AND LIABILITIES

	Notes	19...-		19...-
		\$	\$	\$
AUSTRALIAN GOVERNMENT FUNDS				
Working capital advance	22(a)	....		....
Factory cost subsidy advance	22(b)	....		....
Government investment in fixed	22(c)			
assets less notional				
depreciation		.....	.....	.....
Net Government Funds Invested		.....	.....	.....
These funds are represented by:				
CURRENT ASSETS				
Balance in Trust Account		....		....
Cash at bank		....		....
Cash on hand		....		....
Trade and other debtors	23	....		....
Stock	24	....		....
Prepayments		....		....
Others (specify)		....		....
Notional provisions	25	.....	....	.....
Total Current Assets			....	....
<u>LESS CURRENT LIABILITIES</u>				
Trade and other creditors	26	....		....
Accrued liabilities	27	....		....
Customers advances and equity	28	....		....
Advances repayable within				
12 months	29	....		....
Accumulation repayable to				
Commonwealth Revenue	30	.....		.....
Total Current Liabilities			.....	.....
WORKING CAPITAL (Excess of Current				
Assets over Current Liabilities)			....	....
FIXED ASSETS	31			
Land and buildings less				
notional provision for				
depreciation		....		....
Plant and machinery (including				
office furniture and equipment)				
less notional provision for				
depreciation		....		....
Other fixed assets less notional				
provision for depreciation		.....		.....

	Notes	19...-	19...-
		\$	\$
Net Fixed Assets
<u>Plus</u> Prepayments (advance payments against fixed assets yet to be received)
<u>Less</u> Liabilities (amounts owing on fixed assets already received)
Net Government Investment in Fixed Assets
<u>LESS</u> LONG TERM LIABILITIES
Provisions etc
EXCESS OF FIXED ASSETS OVER LONG TERM LIABILITIES
INTANGIBLE ASSETS
TOTAL NET ASSETS
CONTINGENT LIABILITIES

STATEMENT BY MANAGER AND PRINCIPAL ACCOUNTING OFFICER

To the best of our knowledge and belief the accompanying memorandum statement of assets and liabilities and memorandum trading statement are drawn up so as to give a true and fair view of the state of affairs of the Factory at and a true and fair view of the trading results for the year then ended.

MANAGER
/ /

PRINCIPAL ACCOUNTING OFFICER
/ /

(This certificate may be qualified if appropriate)

NOTES TO AND FORMING PART OF THE ACCOUNTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING METHODS ADOPTED

- (a) The attached accounts are drawn up on the basis of historical costs with the addition of notional cost entries - being costs incurred by the Department of Productivity and other departments on behalf or in support of the Factory but for which recovery from the Factory is not sought. The notional costs are offset by the entry 'Notional Cost Subsidy'.
- (b) The costing procedures and pricing policies of the Factory make allowance for the fact that the levels of Defence production capability, and therefore the facilities and skills the Factory is required to maintain, are in excess of those required for peace time production. The net additional costs of this excess capacity are met by the 'Factory Cost Subsidy'.
- (c) (i) Depreciation is calculated by the straight line method on the historical cost of the assets. Overall rates have been applied to recorded values of plant and machinery and buildings.

- (ii) (if appropriate)

The cost of, or depreciation on, Department of Defence owned items of plant and machinery used by the Factory on production work is not included in the accounting statements.

- (iii) (if appropriate)

Buildings on leased land have been amortized over the life of the lease.

- (d) Tooling held on behalf of customers is not included in the accounting statements.

- (e) Operating costs and operating income include contra amounts:-

\$

- (i) Funded by Department of Housing and Construction:-

Repairs and maintenance

(ii) Funded by Department of Productivity:-

eg Re-arrangement of capital facilities
 Production development
 Plant installation
 Plant manufacture
 Minor new works
 Minor maintenance

(f) Pricing Policy

The following pricing bases are used for charging for work done:-

(i) For Defence orders and Department of Productivity orders, the charges are based on the cost of labour at a manhour rate which includes a standard normal component for overhead absorption plus direct materials, sub-contract work and any other direct expenses.

(ii) For commercial customers (including overseas) when the work is taking up capacity which would otherwise be unused, the charges are at current market rates but never less than direct cost plus 15% on labour cost at direct manhour rates.

(g) Cost of Goods Sold

The form of accounts does not show the cost of goods sold which for the financial year is:

	19... \$	19... \$
Work-in-progress at
Finished goods at
(if appropriate)	_____	_____

Cost of production for
this year	_____	_____
Work-in-progress at
Finished goods at
(if appropriate)	_____	_____
Cost of Goods Sold

(h) Comparative figures for 1977-78 are not shown as financial statements for that year were not subject to audit report.

NOTE 2 - COST OF PRODUCTION

\$

Direct labour:

Direct labour at standard wage rate	.....
Normal manhour absorption	.....
Spending variation	.....
Absorption variation	<u>.....</u>

Sub-Total

Direct material

Sub-contract work

Other direct expenses:

Direct charges	.....
Loading on direct charges	.....
Absorption variation	<u>.....</u>

COST OF PRODUCTION

NOTE 3 - RESERVE CAPACITY COST AND FACTORY COST SUBSIDY

\$

Factory Service Cost Incurred By Current Production

(as per financial records)

Salaries	.....
Salaries overtime	.....
Wages indirect	.....
Materials indirect	.....
Expenses	<u>.....</u>

TotalLESS Factory Service Cost Incurred By Current Production Recovered

By:

Normal manhour rates	...
Direct charges	.....
Loading on direct charges	<u>.....</u>

Factory Service Cost Absorbed

PLUS Spending variationLESS Absorption variation

Normal manhour rates	.....
Loading on direct charges	<u>.....</u> <u>.....</u> <u>.....</u>

Reserve Capacity Cost

PLUS Net Loss For Year

Operating loss	Note 4	.....
Non-operating expenses	" 17	.....
Extraordinary expenses	" 18	.....
Non-operating income	" 19	.....
Extraordinary income	" 20	<u>.....</u> <u>.....</u>

Factory Cost Subsidy

NOTE 4 - OPERATING LOSS

\$

(a) Work-in-progress at	.....
Finished goods at (if appropriate)	.....
	<hr/>	
	
Cost of production for this year	.....
	<hr/>	
	
Work-in-progress at	.....
Finished work at (if appropriate)	.....
	<hr/>	
Cost of goods sold	.....
Sales	.....
	<hr/>	
OPERATING LOSS	<u>.....</u>	

(b) Labour variation

Material variation	.....
Factory service cost spending variation	.....
Factory service cost absorption variation	.....
Losses/Gains on pricing	.....
of orders	<hr/>

OPERATING LOSS	<hr/>

NOTE 5 - LABOUR VARIATION

The labour used in production of fixed price orders
was \$..... more/less than estimated.

NOTE 6 - MATERIAL VARIATION

The direct material used in production of fixed price
orders was \$..... more/less than estimated.

NOTE 7 - FACTORY SERVICE COST SPENDING VARIATION

Variations from standard factory service costs
amounted to \$..... and comprised:-

	\$
Wages	.....
Salaries	.....
Indirect materials	.....
Expenses	.....

NOTE 8 - FACTORY SERVICE COST ABSORPTION VARIATION

The variation from standard absorption amounted to
\$ comprising:-

	\$
Over absorbed by:	
Normal manhour rates	.....
Other direct expenses	<u>.....</u>
Net over absorption	<u>.....</u>

NOTE 9 - AUDIT FEES (as advised by Auditor-General's Office) \$

NOTE 10 - ADMINISTRATIVE SUPPORT

\$

Other administrative support provided by
Government departments. This amount has been
calculated by taking ...% of the total
operating cost to cover support by the
Department of Productivity and other
Government departments. This percentage was
determined on the result of a survey of administrative
costs in certain departments conducted for the Factory
financial year ended 30 May 1976.

NOTE 11 - DEPRECIATION

\$

Plant and machinery at 7.7%	.....
Buildings at 2%	.....
Leases (if applicable)	<u>.....</u>
Total	<u>.....</u>

NOTE 12 - INTEREST ON CAPITAL

\$

Calculated at long term bond rates
on working capital advance.

Rates applied:

NOTE 13 - SUPERANNUATION

\$

A rate of 25% (assessed by Australian Government Actuary) applied to the annual salaries and wages cost of contributors.

NOTE 14 - REPAIRS AND MAINTENANCE

\$

Gross expenditure (Department of Housing and Construction)

Less - amount recovered from Department of Housing and Construction for work done by the Factory (See also note 1(e))

Repairs and maintenance cost funded by Department of Housing and Construction and paid by that Department to commercial contractors and others.

NOTE 15 - INSURANCE

\$

Insurance costs at rates assessed by the Insurance Council of Australia.

Fire and general:

Buildings and works
Plant and machinery
Stores stock
Work-in-progress
Finished stock

Consequential:

Wages

Total

Value of buildings, works, plant and machinery used for insurance assessment is the original cost of these assets without deduction for depreciation.

NOTE 16 - OTHER EXPENSES (Provisions)	\$
Annual provision for furlough - 8% of total wages and salaries (Rate advised by Australian Government Actuary)	.....
<u>Less Furlough paid during year</u>	.....
Notional provision for year	_____
Provision for doubtful debts - increase/decrease allowed for year _____
Total _____

NOTE 17 - NON-OPERATING EXPENSES	\$
eg Loss on sale of stores stock	.....
Loss on sale of finished goods stock (eg disposal of obsolete items)	.....
Loss on sheep trading	.....
Stores stock prices adjustments	.....
Stores stock valuation adjustments	.....
Production written off	.....
Others (specify)	.....

NOTE 18 - EXTRAORDINARY EXPENSES	\$
eg Loss on currency revaluation	.....
Loss on change in excise duties	.....
Others (specify)	.....
NOTE 19 - NON-OPERATING INCOME	\$
eg Discount received	.....
Profit on sale of stores stock	.....
Rent received	.....
Stores stocktaking adjustment	.....
Other (specify)	.....

NOTE 20 - EXTRAORDINARY INCOME	\$
eg Profit on currency revaluation	.....
Profit on change in excise duties	.....
Other (specify)	.....

NOTE 21 - VARIATION IN WORK-IN-PROGRESS AND STOCKS OF

FINISHED GOODS (if appropriate)

	Work-in-progress	Less: Progress payments claimed	Net WIP	Finished goods (if appropriate)
	\$	\$	\$	\$
Last year	.....	.....	.....	.....
This year	.....	.....	.....	.....
	-----	-----	-----	-----
Variation	.....	.....	.....	.....
	-----	-----	-----	-----
	Work-in-progress valued at			
	Finished goods valued at (if applicable)			

This item incorporates the variation in inventories into the Memorandum Trading Statement to ascertain the net cost of operation and retention of the factory.

NOTE 22

AUSTRALIAN GOVERNMENT FUNDS

(a)	Working Capital Advance			\$
	Date of advance	Amount of advance(s)	Amount repaid	Amount of advance outstanding
		\$	\$	\$

From previous years

19 to 19	.....	.....	.....
19 to 19	.....	.....	.....

(b)	Factory Cost Subsidy Advance			\$
-----	------------------------------	--	--	----------

	Date of advance	Amount of advance(s)	Amount repaid	Amount of advance outstanding
		\$	\$	\$

From previous years

19 to 19	.....	.....	.....
19 to 19	.....	.....	.....

This advance is to cover costs incurred which are recoverable from factory cost subsidy but require processing before recovery is made.

(c)	This amount is identical with net Government investment in fixed assets - see entry under 'Working Capital' in the statement of assets and liabilities.			
-----	---	--	--	--

NOTE 23	TRADE AND OTHER DEBTORS		
		\$	\$
	Trade debtors	.....
	Less provision for doubtful debts	<u>.....</u>	.....
	Other debtors		
	(a) Reserve capacity subsidy	.....
	(b) Accrued leave	.....
	(c) Others (specify)	<u>.....</u>	<u>.....</u>
	The provision for doubtful debts was calculated on the basis of past experience at % on non-government debts outstanding at end of year.		
	Accrued leave will be recovered from customers or from factory cost subsidy in the year in which payment is made.		

NOTE 24	STOCK		
		\$	\$
	Stores (state basis of valuation)	.....	.....
	Work-in-progress	.....	.....
	Finished goods	<u>.....</u>	<u>.....</u>

NOTE 25	NOTIONAL PROVISIONS		\$
	Furlough - see note 16 and contra 27 (furlough)	.....
	Doubtful debts - see note 23 contra	<u>.....</u>	
	No provisions are actually made. Furlough and bad debts are accounted for in the factory costing system in the year in which payment is made or the loss written off.		

NOTE 26	TRADE AND OTHER CREDITORS		\$
	Trade creditors	.....
	Other creditors	<u>.....</u>	

NOTE 27	ACCRUED LIABILITIES		\$
	Salaries	.....
	Wages	.....
	Expenses	.....
	Accrued leave - recreation	.....
	Furlough (see also notes 1 and 25)	<u>.....</u>	

NOTE 28	CUSTOMERS ADVANCES AND EQUITY		
	This item indicates obligations against orders where advances and payments have been claimed from customers but goods have yet to be delivered.		

NOTE 29	ADVANCES REPAYABLE WITHIN 12 MONTHS		\$
	Description and nature of advance		
	
	<u>.....</u>	

NOTE 30	ACCUMULATION REPAYABLE TO COMMONWEALTH REVENUE		
	Specify nature and composition, eg trading profit from previous years.		

FIXED ASSETS

			\$	\$
Land at	.... hectares	.... year 19 -	cost	.....
		.... year 19 -		.....
	
			
		Total cost of land		.....
		<u>Less</u> amount written off*		.....
			
		Net value land		.....
Buildings				
at	....	year 19 -	cost	.....
at	....	year 19 -		.....
			
		Total cost of buildings		.....
		<u>Less</u> - amount written off*		
		- depreciation	.....	.....
			
		Net value buildings		.....
Plant and machinery (including				
office furniture and equipment)				
		year 19 -	cost	.....
		year 19 -		.....
			
		Total cost of plant & machinery		.....
		<u>Less</u> - amount written off*		
		- depreciation	.....	.....
			
		Net value plant and machinery		.....
Other fixed assets - (including leased land				
and buildings thereon if appropriate)				
		year 19 -	cost	.....
		19 -		.....
			
		Total cost of other fixed assets		.....
		<u>Less</u> - amount written off*		
		- depreciation	.....	.....
			
		Net value other fixed assets		.....
			

Net Fixed Assets

* This is the book value of items actually written off or disposed of as distinct from the value of items written down by depreciation.

Issues Raised by the Auditor-General in His 1979-80
Report But Satisfactorily Resolved at Time of Inquiry

ISSUES RAISED BY THE AUDITOR-GENERAL AND SATISFACTORILY

RESOLVED AT TIME OF INQUIRY

- . Failure to issue promptly taxation group certificates
The Auditor-General noted in his report that reviews by his office revealed that the accumulation of group certificates since 1 July 1979 had been cleared and group certificates were being issued promptly on termination of employment.
- . Controls over the Register of Unclaimed Wages to prevent manipulation
A detailed check is regularly undertaken to prevent any illegal alteration of the unclaimed wages register. The effectiveness of the control ledger reconciliation has been improved and reconciliations of unpaid salaries and wages are being effected at the end of each accounting period.
- . Absence of proper delegations to engage or discharge employees and approve overtime.
Instruments of delegation have now been issued in relation to the engagement/discharge of employees and for approval of overtime and these delegations are now being followed.
- . Security of payroll during distribution
The concern expressed by Audit in relation to security of the payroll was related mainly to one of the pay teams carrying all envelopes to the first pay point and to proper identification of payees. Pay envelopes for the second pay point now remain in the pay office while envelopes for the first pay point are being distributed. Revised instructions have been issued regarding the identification of payees either by factory pass or by an identifying officer.
- . The need for regular checks upon leave records and paysheets.
Arrangements have now been made for arithmetical checks of leave records and directions have been issued regarding the requirements for paysheets to be checked for bogus names at least once every year. This check has recently been undertaken.
- . Review of excessive recreation leave credits
Leave cards are now being reviewed on a regular basis with advices being issued to supervisors and employees at the beginning of May and October of each year for employees who have accrued recreation leave

credits in excess of 40 hours. Those advices request that suitable arrangements are made for the leave to be taken before the end of the year.

- . The need for regular medical reviews of compensation cases when the person concerned continues in employment.
Extended or frequent compensation sick leave cases now reviewed regularly.

Schedule of Internal Audits Undertaken at GAF
in 1978/79, 1979/80 and 1980/81

SCHEDULE OF INTERNAL AUDITS ACTUALLY UNDERTAKEN AT G.A.F. IN PAST
THREE YEARS

1978/79

- . Personnel Systems - Salaried Staff
- . Treasury Group
- . Expenditure - Special Review
- . Vehicle Fuel and Oils
- . Vehicle Control Procedures
- . Salaries
- . Creditors
- . Computer Report (C.P. 13)
- . Special-Task Inspection (ADP), Member Working Party, G.A.F. Review

1979/80

- . Treasury Group
- . Special Investigations:-
 - i) Review of Auditor-General's Office Queries
 - . Undue delay in Payment of Creditors' Claims
 - . Prepayments
 - . Unclaimed Salaries and Wages
 - . Adjustment of Advances
 - . Debtors
 - . Selling Price - Nomad Aircraft
 - . Sale of Nomad Aircraft to Douglas Airways
 - . Development Costs - Nomad Aircraft
 - . Rearrangement of Capital Facilities Vote.
 - ii) Review of Tenders for Computerised Payroll Service.

1980/81

- . Control Ledger
- . Appropriation Ledger
- . Personnel - Wages Area
- . Special Investigation

Review of Auditor-General's Office Queries:-

- . Nomad Aircraft - Calculation of W.I.P. Salaries
- . Salaries
- . Assets, Land and Buildings
- . Work in Progress
- . Control over Processing of Daily Time Bookings
- . Weekly Time Bookings - Salaried Staff
- . Accrued Liabilities
- . Accrual Accounting

- . Computer Transactions Stage 1
- . Orders Over Expended/Under Funded
- . Reconciliations - Control Ledger
- . Plant and Machinery, Office Equipment and Furniture.

INTERNAL AUDIT PROGRAM 1979/80 AND 1980/81 GOVERNMENT AIRCRAFT
FACTORIES

The following items were included in the approved internal audit
programs for 1979/80 and 1980/81 for the G.A.F. area:

1979/80

- . Creditors
- . Treasury Group
 - Advances.- Permanent and Temporary
 - Public Moneys - Collection and Disposal
 - Custody of Keys to Public Moneys Receptacles
 - Accountable Forms
 - Postage and Franking Machines
 - Decensed Estates
- . Appropriation Ledger
- . Control Ledger
- . Debtors

1980/81

- a) Victorian Regional Staff
 - . Control Ledger
 - . Appropriation Ledger
 - . Labour Controls
 - . Personnel - Salaried staff (follow up)
 - . Personnel-Wages area
 - . Special Investigation:-
 - Assist in review of Auditor-General's Office Queries
- b) Central Administration - Inspectorial Staff.
 - . Special Investigation:-
 - Review matters relating to G.A.F. activities raised with the
Department by the Auditor General's Office since 1 July 1977.

ANNEX G

Staff Turnover in Internal Audit Areas Having
Responsibility for Defence Production Undertakings -

1 July 1977 to 30 June 1981

STAFF TURNOVER IN DEPARTMENT OF INDUSTRY AND COMMERCEANNEX HINTERNAL AUDIT AREAS

	<u>ESTABL. CEILING</u>	<u>ACTUAL</u> (JUN 81)	<u>OUTGOING</u>	<u>AVG. ANNUAL</u> (CEILING)
CENTRAL ADMINISTRATION				
Canberra	2	2	2	13
Melbourne	3	3	3	25
A.C.T. AREA	3	3	3	4
				33
REGIONAL STAFF				
Victoria	6	5	5	14
NSW	3	3	1	9
SA	1	1	0	2
				50
TOTAL	14	17	14	33
				50 (approx)

Note: The above turnover figures have been calculated on 'lost staff' only - internal promotions within the internal audit area would substantially increase the average annual turnover if calculated on a position basis.
(Committee File 1980/7)

Programs contained on Burroughs B1726 System at GAF

PROGRAMS CONTAINED ON BURROUGHS B1726 SYSTEM AT GAF

- (a) Work-in-Progress System.
Accumulation of direct labour hours and direct material expended on manufactured parts.
- (b) Job Costing.
Accumulation of labour costs, material costs and other direct costs expended by each cost centre against work authorities.
- (c) Project Cost Control.
Accumulation and dissection of costs at project level.
- (d) Overhead Costing.
Accumulation of all indirect costs expended during the year i.e. Factory Service Costs.
- (e) Debtors.
Monitoring of actual costs, funds and claims for each customer order received. This system is used to monitor expenditure and recoveries against appropriations.
- (f) Creditors.
Monitoring claims for payment for goods and services.
- (g) Budget Control.
Monitoring actual expenditure against budget.
- (h) Purchasing.
Monitoring of purchasing activities e.g. receipt of demand, tendering, ordering and goods receipt.
- (i) Parts Tracking.
Registration of last movement of parts on shop floor.
- (j) Nomad Spares Price List.
Calculation of cost price and selling price of all Nomad spares.
- (k) Bill of Material.
Definition of the design and planning product structure for GAF manufactured parts.
- (l) Routing.
List of operations required to manufacture a part.
- (m) Avalon Stage Assembly.
Specialised report to show progress of all Nomad Stage assemblies at Avalon.

- (n) Materials Issues.
Monitoring of stores documents to ensure that materials issued are promptly charged to the job costing system.
- (o) Materials Testing.
Monitoring of progress of material testing through the various laboratories.
- (p) User Enquiries.
Various programs are available to allow the users to interrogate data bases on line.

PROGRAMS CONTAINED ON BURROUGHS B1726 SYSTEM AT GAF

- (a) Work-in-Progress System.
Accumulation of direct labour hours and direct material expended on manufactured parts.
- (b) Job Costing.
Accumulation of labour costs, material costs and other direct costs expended by each cost centre against work authorities.
- (c) Project Cost Control.
Accumulation and dissection of costs at project level.
- (d) Overhead Costing.
Accumulation of all indirect costs expended during the year i.e. Factory Service Costs.
- (e) Debtors.
Monitoring of actual costs, funds and claims for each customer order received. This system is used to monitor expenditure and recoveries against appropriations.
- (f) Creditors.
Monitoring claims for payment for goods and services.
- (g) Budget Control.
Monitoring actual expenditure against budget.
- (h) Purchasing.
Monitoring of purchasing activities e.g. receipt of demand, tendering, ordering and goods receipt.
- (i) Parts Tracking.
Registration of last movement of parts on shop floor.
- (j) Nomad Spares Price List.
Calculation of cost price and selling price of all Nomad spares.
- (k) Bill of Material.
Definition of the design and planning product structure for GAF manufactured parts.
- (l) Routing.
List of operations required to manufacture a part.
- (m) Avalon Stage Assembly.
Specialised report to show progress of all Nomad Stage assemblies at Avalon.

- (n) Materials Issues.
Monitoring of stores documents to ensure that materials issued are promptly charged to the job costing system.
- (o) Materials Testing.
Monitoring of progress of material testing through the various laboratories.
- (p) User Enquiries.
Various programs are available to allow the users to interrogate data bases on line.