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SOUTH AUSTRALIA

Report

of the

Auditor-General

for the

Year ended 30 June 2001

Tabled in the House of Assembly and ordered to be published, 2 October 2001

Fourth Session, Forty-Ninth Parliament

PART A

Audit Overview

By Authority: J. D. Ferguson, Government Printer, South Australia

2001

Government of South Australia

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28 September 2001

The Hon J C Irwin, MLC
President
Legislative Council
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The Hon J K G Oswald, MP
Speaker
House of Assembly
Parliament House
ADELAIDE SA 5000

Gentlemen,

AUDITOR-GENERAL'S REPORT 2000-01

Pursuant to the provisions of the *Public Finance and Audit Act 1987*, I herewith provide to each of you a copy of my 2001 Annual Report. This Report includes the Honourable the Treasurer's Statements for the financial year ended 30 June 2001.

Content of the Report

This Report is in two parts – Part A and Part B.

Part A –The Audit Overview is a general review of, and report on, the public finances of the State. It also contains a commentary of Audit findings and comment concerning specific issues of importance and interest in the public sector that are brought to the attention of the Government and the Parliament pursuant to the provisions of subsections 36(1)(a)(iii) and 36(1)(b) of the *Public Finance and Audit Act 1987*.

Part B – Volumes I, II and III contain comment on the operations of individual public authorities, the financial statements of those public authorities, and the Treasurer's Statements. A number of matters that, in my opinion, are of administrative significance or importance to the Government and the Parliament that are contained in Part B of this Report are listed separately under the heading 'References to Matters of Significance'. This list can be found immediately after the Table of Contents in the front of Volumes I, II and III of Part B.

Independent Audit Opinion

In accordance with subsection 36(1)(a) of the *Public Finance and Audit Act 1987*, and subject to comments made within this Report, I state, that in my opinion:

(i) **the Treasurer's Statements reflect the financial transactions of the Treasurer as shown in the accounts and records of the Treasurer for the financial year ended 30 June 2001;**

(ii) **the financial statements of each public authority reflect the financial transactions of the authority as shown in the accounts and records of the authority;**

(iii) **the controls exercised by the Treasurer and public authorities in relation to the receipt, expenditure and investment of money; the acquisition and disposal of property; and the incurring of liabilities, are sufficient to provide reasonable assurance that the financial transactions of the Treasurer and public authorities have been conducted properly and in accordance with law.**

Whilst I have not seen fit to express a qualified opinion with respect to matters referred to in subsection 36(1)(a)(iii) above, there have been cases where in some agencies, systems of internal controls have not, in my opinion, been of an acceptable standard. Where this has occurred, I have, in accordance with the provisions of subsection 36(1) of the *Public Finance and Audit Act 1987*, drawn attention to this fact and included comment on my reason(s) in the report on the agency concerned in Part B of this Report.

Report and Opinion on Controls

As required by subsection 36(1)(a)(iii) of the *Public Finance and Audit Act 1987*, the audit included an assessment of the controls exercised by the Treasurer and public authorities in relation to the receipt, expenditure and investment of money, the acquisition and disposal of property and the incurring of liabilities and also, where applicable, whether the controls in operation were consistent with the prescribed principles of the Financial Management Framework as required by Treasurer's Instruction 2 'Financial Management Framework'. The overall aim of that assessment was to establish whether those controls were sufficient to provide reasonable assurance that the financial transactions have been conducted properly and in accordance with the law.

It is not practical in any such assessment to review each and every control in respect of each and every transaction. Whilst every effort is made to test the sufficiency of controls across a representative range of transactions, it must be remembered that no system of control is 'fail-safe'.

The Parliament has recognised this in stating that the controls need only be sufficient to provide, at the time of audit, 'reasonable assurance' of the matters set out in subsection 36(1)(a)(iii).

The Audit assessment has been made by reviewing the adequacy of procedures and testing a number of control components against a range of financial transactions conducted at various levels of the organisation.

In assessing the sufficiency of these controls, particular regard has been had to the organisation's structure and the inter-relation of procedures, policies, people, management's philosophy and operating style, demonstrated competence, and overall organisational ethics and culture. All of these matters serve as inter-related elements of control.

The standard by which Audit has judged the sufficiency of controls is whether and how well those controls provide reasonable assurance that financial transactions of the Treasurer and public authorities have been 'conducted properly and in accordance with law'. This concept requires the organisation to meet the standards of financial probity and propriety expected of a public authority and, at all times, discharge its responsibilities within the letter and spirit of the law, both in terms of its own charter and as an instrumentality of government discharging public functions.

Except for the matters detailed for each agency in Part B of my Report under the section 'Audit Findings and Comments', Audit formed the opinion that the controls exercised in relation to the receipt, expenditure and investment of money; the acquisition and disposal of property; and the incurring of liabilities were sufficient to provide reasonable assurance that the financial transactions were conducted properly and in accordance with the law. In respect of those matters where the controls exercised were not sufficient to provide that level of assurance, Audit has made recommendations as to where improvements are required.

Qualified Audit Opinions

It was found necessary to issue a qualified audit opinion in the Independent Audit Report in seven instances. The agencies concerned are:

- Administrative and Information Services - Department for
- Correctional Services - Department for
- Country Fire Service Board
- Education, Training and Employment - Department of
- Environment and Heritage - Department for
- SA TAB Pty Ltd
- South Australian Forestry Corporation
- South Australian Metropolitan Fire Service
- South Australian Motor Sport Board
- Water Resources - Department for

The reason for, and the extent of, the qualification in the Independent Audit Report is described in the commentary on each of those agencies to be found in Volume I, II or III of Part B of this Report.

Acknowledgments

I would like to place on record my gratitude for the dedicated efforts of my staff throughout the financial year. Their professionalism and dedication have been of the highest order. Their efforts are reflected in the contents of this Report.

I extend my thanks to the Under Treasurer, Riverside 2000 and their staff, and the report printing coordinator Mr D O'Keefe for their efforts which have assisted materially in the production of this Report. The cooperation of all public authorities with my staff during the financial year is also acknowledged.

Yours sincerely,

K I MacPherson
AUDITOR-GENERAL

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MEMORANDUM TO PARLIAMENT

INTRODUCTION

My Reports in the past few years have made reference to the significance of change that has been taking place within the public sector of this State. This is a direct consequence of the introduction of a series of administrative reforms relating to public sector management, performance, and accountability and the structural changes in the way government is delivering its programs and services. There have also been major technological, infrastructure and economic changes that have taken place that directly impact on the government's financial position.

This wide ranging change process which is continuing brings with it a change in the overall risk profile of government and its agencies.

The audit program this year, in addition to conducting independent audits of government and public sector agencies operations has been mindful of the systemic changes that have been taking place. It is accepted by me as Auditor-General that I have a responsibility to ensure that there are no latent liabilities that exist that are not brought to the attention of the Parliament in a timely way. No auditor, whether in the public or the private sector can ignore the experience of the major private sector collapses that have taken place in the past year.[1] The experience of these companies emphasises the fact that appearances often belie the underlying financial reality.

PURPOSE OF THIS MEMORANDUM

This Memorandum serves to summarise certain matters of significance regarding the 2000-01 audit program of this Department. In this regard it discusses matters of importance associated with the execution of the audit process. This includes the conduct and outcomes of reviews of the public finances and accounts, the operations of public sector agencies, and public sector financial reporting.

THE AUDIT PROCESS

Implementation of Revised Audit Methodology

The mandate given to the Auditor-General for the performance of audits in terms of the *Public Finance and Audit Act 1987* is notably silent with respect to the manner in which those audits are to be conducted. It is left to the Auditor-General to determine the most appropriate audit methodology to use. This is consistent with the principle of the statutory independence of the Office of the Auditor-General.

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[1] eg Harris Scarfe Limited; HIH Limited; One-Tel Limited; Ansett Airways Limited; and Pasminco Limited.

In determining the most appropriate audit methodology to use, it is important that any methodology chosen represents best practice and contributes to the overall efficiency and effectiveness of audits conducted by the Department.

During 2000-01, the Department completed a phased implementation of a revised audit methodology that supports the performance of the financial compliance and internal control audits conducted by the Department. The licence to use this audit methodology was obtained from one of the large global accounting firms.

The implementation process required a limited refinement of the methodology to suit the public sector environment, a comprehensive training program for all audit officers, and the dedicated support and effort of those officers in introducing and applying the revised methodology to agency audits. The major commitment of the Department's resources to the change process resulted in a successful implementation and the establishment of a solid foundation for the conduct of future financial compliance and internal control audits.

Further detailed information on the implementation of the audit methodology is included in the Report on the Operations of the Auditor-General's Department for the year ended 30 June 2001.

PUBLIC FINANCES

The State's Finances 2000-01

The 2000-01 financial year saw the realisation of two significant events that have changed the structure of the State's finances from the immediate past. The first is implementation of national tax reform resulting in the State receiving revenue generated by the Goods and Services Tax and the abolition of some State taxes. The second event was the completion of the disposal of the State's public electricity assets. The disposal of the electricity assets has brought immediate reductions in net debt with total net proceeds amounting to $4.9 billion being used for debt retirement over the past two years.

Operating Result

Operations of the Government non-commercial sector in 2000-01 are estimated to result in a deficit (before adjusting for abnormals) of $74 million (measured on the Government Finance Statistics (GFS) cash based method).

After adjusting for abnormals, the underlying result is an estimated surplus of $3 million in line with the 2000-01 Budget.

Estimated outlays total $7.2 billion exceeding Budget by $313 million or 4.5 percent. Revenues total $7.1 billion and exceed Budget by $269 million or 3.9 percent. Better than planned revenues were mainly from Commonwealth grants and State taxation.

As has been past practice, to achieve the Budget targets, the Government has deferred some budgeted revenues and brought forward some future payments. For the most part, such transactions are simply presentational. I have observed that the achievement of the cash based budget target is readily accommodated through timing of transactions. In these circumstances the structural soundness of the Budget is a more important element than the 'headline' result.

I have noted in 'The Accrual Budget' in this Part of the Report that I believe it is imperative for the Government to set out the details of a revised long-term basis for fiscal strategy and related monitoring and reporting. The GFS accrual basis, currently suggested by the Department of Treasury and Finance as an alternative to the existing cash based method, is, in my view, a better basis for the long term.

2000-01 - Net Debt and Unfunded Superannuation

Two key targets in the Government's current four-year financial plan are the reduction of net debt in real terms and the elimination of the State's unfunded superannuation liability by 2034.

Net debt at 30 June 2001 was $3.3 billion a reduction of $1.1 billion from the previous year as a result of the application of proceeds from the disposal of electricity assets in 2000-01 to debt retirement.

The estimated unfunded superannuation liability as at 30 June 2001 was $3.3 billion. This was a reduction from the previous year of $242 million. The estimated liability was reduced by $618.5 million in 2000-01 based on an independent actuarial review completed in September 2000. Other factors resulted in increases that offset the reduction. The position as at 30 June 2001 is consistent with the plan to eliminate unfunded superannuation liabilities by 2034.

The 2001-02 Budget and Forward Estimates - Cash Basis

As in the past, observations on the forward Budget data have been made in this Report. The following are some salient points from the commentary.

The 2001-02 Budget projects a deficit (before abnormals) in 2001-02 and then small surpluses thereafter. It is notable that in the last three years, projected outcomes (before abnormals) have not been achieved and in fact, persistent, higher than budgeted deficits (before abnormals) have been incurred. After abnormals, the estimated result for 2000-01 is in line with budget as is the Budget result for 2001-02.

Decreases, in real terms, are projected in total outlays and total revenues over the forward period. Audit analysis shows that for the three years to 2000-01, total outlays have increased annually in real terms.

Large distributions are projected to be received from the reserves of the South Australian Asset Management Corporation (SAAMC) and the South Australian Government Financing

Authority (SAFA). I do not consider these to represent ongoing sustainable distributions as SAAMC and SAFA do not currently have the capacity to earn future profits of the order of the budgeted distributions. I note that such distributions have been projected in previous Budgets but that these entities made no dividend distributions in 2000-01 or the previous two years.

Overall, the Budget does not indicate much flexibility over the forward estimates period in cash terms or when considering the accrual results. This emphasises the need for managing the actual performance against budget and for control of spending the State's resources.

In the longer term, the Government anticipates that South Australia will gain from tax reform from 2006-07 because the Goods and Services Tax (GST) is a growth tax.

2001-02 Budgeted Results - Accrual Basis - General Government Sector

The 2001-02 Budget sets out accrual estimates for the Australian Bureau of Statistics defined General Government sector, notwithstanding that the primary Budget targets are cash based for the non-commercial sector. The data is prepared on the basis of the recently adopted accrual GFS method.

The data indicates anticipated improvements in both the operating and fiscal balance (net borrowing) data in 2001-02 over 2000-01 as a result of increased revenues. Further improvements are estimated over the remaining period of the forward estimates to 2004-05. An operating surplus is forecast for the first time in 2002-03. Notwithstanding the projected improvements, the General Government sector is projected to continue to need borrowings through to 2004-05 to fund some part of capital expenditure.

Both total assets and liabilities are projected to increase over the forward estimates period and net worth (net assets) is estimated to improve in nominal terms.

Asset Disposals

Disposal of Government-Owned Electricity Businesses

In the Memorandum to Parliament in my 2000 Report of the Auditor-General, I indicated an intention to table a number of reports relating to the disposal process for the government-owned electricity businesses. During 2000-01 the following Supplementary Reports were tabled:

- Supplementary Report of the Auditor-General on 'Electricity Businesses Disposal Process in South Australia: Engagement of Advisers: Some Audit Observations' dated 28 November 2000.

- Supplementary Report of the Auditor-General on 'Electricity Businesses Disposal Process in South Australia: Arrangements for the Disposal of ETSA Utilities Pty Ltd and ETSA Power Pty Ltd: Some Audit Observations' dated 30 November 2000.

- Supplementary Report of the Auditor-General on ‘Electricity Businesses Disposal Process in South Australia: Arrangements for the Disposal of Optima Energy Pty Ltd, Synergen Pty Ltd, Flinders Power Pty Ltd, Terra Gas trader Pty Ltd and ElectraNet SA: Some Audit Observations’ dated 14 March 2001.

In addition to these Reports, on 20 March 2001 I tabled a Report of the Auditor-General pursuant to Section 22(2) of the *Electricity Corporations (Restructuring and Disposal) Act 1999* on ‘Electricity Business Disposal Process in South Australia: Report by the Auditor-General Pursuant to Section 22(2) of the *Electricity Corporations (Restructuring and Disposal) Act 1999* on Relevant Long Term Leases’. This Report included commentary on the use of the proceeds from the disposals, the estimated interest savings resulting from the use of those proceeds to retire debt, the effect of the disposals on the Public Finances, and the probity of the disposal process.

Commentary in Part B of this Report under Electricity Supply Industry — Overview, contains a summary of the proceeds from the disposal process.

Other Asset Disposals

In August 2001, Cabinet approved the sale of the SA Tab Pty Ltd (formerly known as the South Australian Totalizator Agency Board) to TAB Queensland Limited. Final settlement of the sale is expected to occur in January 2002, subject to probity checks.

At the date of finalisation of this Report, the Government had not made a decision on the results of the divestment process for the South Australian Ports Corporation.

More detailed comments in respect to these matters are set out in the State’s Finances and Related Matters section in this Part of the Report under the heading Asset Disposals.

PUBLIC SECTOR FINANCIAL REPORTING

Agency Financial Statements — Form and Content Changes

The financial statements prepared by an entity have been traditionally known as the Profit and Loss Statement (also called an Operating Statement in relation to government departments), the Balance Sheet (also called the Statement of Financial Position in relation to government departments) and the Statement of Cash Flows.

In accordance with the Accounting Standards prepared by the Australian Accounting Standards Board, the titles of the financial statements changed for the financial year ending 30 June 2001. The new titles are Statement of Financial Performance (in lieu of Profit and Loss Statement), Statement of Financial Position (in lieu of Balance Sheet) and Statement of Cash Flows (unchanged).

With respect to the Statement of Financial Performance, there have also been changes to the format and content. The most significant changes relate to the disclosures in this Statement being only for results from operations. Disclosures relating to accumulated profits or funds and appropriations to/from reserves and dividends (ie matters associated with ownership rather than performance) are now disclosed in the Notes to the Financial Statements.

The financial statements of all entities included in this Report reflect this new presentation style.

Further detailed commentary with respect to the changes to financial statements is included in Part B of this Report under the heading 'Major Changes in the Presentation of Information in the Financial Statements for 2000-01'.

Asset Valuation Methodology — A Significant Issue for Deliberation

Accounting Policy Statement No 3 'Revaluation of Non-Current Assets' issued by the Treasurer in terms of the *Public Finance and Audit Act 1987* requires non-current assets, or a group of non-current assets, with an acquisition cost of greater than $1 million to be revalued at intervals not exceeding three years. The methodology to be used for the revaluation is the deprival value basis which is defined as '… the entire loss, both direct and indirect, that might be expected to be incurred by an entity if that entity were deprived of the asset …'.

The adoption of deprival value resulted from work undertaken by an Asset Valuation Sub-committee of the Steering Committee on National Performance Monitoring of Government Trading Enterprises (the Committee) established at the Special Premiers' Conference in July 1991. The Committee produced Guidelines for the valuation of assets in October 1994 and commented 'Jurisdictions are encouraged to adopt this framework to ensure a consistent approach to the valuation of assets'.

This approach which was developed and implemented at a considerable cost, was designed specifically for Government assets which in many cases are unique and have in most cases no equivalent in the private sector.

The Australian Accounting Standard AAS 38 'Revaluation of Non-Current Assets' was issued in December 1999 and is operative for reporting periods beginning on or after 1 July 2000. The Accounting Standard requires assets to be valued using the cost basis or fair value basis where fair value is defined as '… the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction'.

There is, however, a transitional provision in the Accounting Standard for public sector entities to retain the existing basis of valuation until 30 June 2002. This transitional provision is also reiterated in Accounting Policy Statement No 3.

Audit understands that the professional accounting bodies in Australia and the Department of Treasury and Finance are currently considering the implications of using the deprival value methodology to value non-current assets rather than the fair value basis as prescribed in the Accounting Standard.

Prior to any decision to make a change it is imperative that the Treasurer, through the Department of Treasury and Finance be totally satisfied that the fair value basis adequately accounts and reports on the values of all government assets, including those unique to the public sector.

I intend to raise this matter with the Department of Treasury and Finance in 2001-02.

Agency Financial Statements — Administered Items — Quality of Financial Reporting

In accordance with Accounting Standards, all agencies prepare and present a Statement of Financial Performance. It is possible, however, for items relating to the activities conducted by the agency to be either disclosed on the face of that financial statement or in the notes to the financial statements as 'administered items'. The criteria applied as to the placement of the disclosure of an item relates to whether or not the agency is able to exercise control over that item for its own benefit.

Audit has observed that there are many activities of government that are reported as 'administered items'. I am of the opinion that there is a need to re-assess the arrangements for 'administered items'.

Where agencies are not regarded as 'controlling' a particular item, there is, in my opinion, a risk that a lower level of attention will be afforded to the management of that item.

It would be prudent, in my opinion, to eliminate this risk wherever possible by structuring arrangements and responsibilities such that control of an item by a specific agency can be clearly established. As a consequence, items will therefore be reported as being controlled by an agency rather than as 'administered items'.

I intend to raise this matter with the Department of Treasury and Finance in 2001-02.

Knowledge of Public Sector Finance Officers

As mentioned previously under the heading 'Agency Financial Statements — Form and Content Changes', there have been significant changes to the nature of the financial statements to be prepared by an entity. These changes were first announced by the Australian Accounting Standards Board in October 1999 and were operative from reporting periods beginning on or after 1 July 2000, unless adopted earlier. Accounting Policy Statement No. 13 'Form and Content of General Purpose Financial Reports', issued by the Treasurer in terms of the *Public Finance and Audit Act 1987*, required the revised

Accounting Standards to be adopted for the accounting period commencing 1 July 2000 and ending on 30 June 2001.

Subsection 23(1) of the *Public Finance and Audit Act 1987* requires public authorities to deliver, to the Auditor-General, within 42 days of the end of the financial year, financial statements relating to that financial year. A review by Audit of the delivered financial statements for compliance with the revised Accounting Standards revealed that an inordinate number of these financial statements did not comply with the new form and content. Such a position is, in my opinion, unacceptable and reflects adversely on the skills and knowledge of public sector finance officers.

In 1994 and 1995 in Part A of my Report to Parliament, I commented on the need for '… appropriately trained personnel …' and that '… there is no room for "sloppiness" in the hope that Audit will provide the necessary guidance or assistance …'.

It is, in my opinion, essential that officers within the South Australian public sector, with responsibilities for financial management and reporting, maintain their professional knowledge by remaining abreast of developments within the profession. Indeed, members of the professional accounting bodies are required, for continuing membership, to undertake a prescribed number of hours of professional development.

PUBLIC GOVERNANCE

Previous Reports have raised issues relevant to certain important elements of public governance. They have included the importance of the roles and responsibilities of public office holders (Members of Parliament; Ministers; and public servants); performance employment contracts of senior executives of the public service; and administrative and financial policy and accountability initiatives pursued through formal frameworks (budget reform; asset management; financial management and procurement improvement).

I have included in this Report some further comments on certain matters of public governance.

Performance Employment Contracts

In the last two reports to Parliament, Audit has drawn attention to inadequacies in the existing contractual arrangements with Chief Executives and in the management of the relationship between Ministers and Chief Executives that directly and indirectly impact on the financial position of the State. These inadequacies centred around the absence of contractual performance provisions and associated procedures.

In March 2001, the Commissioner for Public Employment obtained the Premier's endorsement of a proposed approach to performance agreements for Chief Executives in the South Australian public service and to the process of assessing the performance of each portfolio Chief Executive.

Under these new arrangements, all portfolio Chief Executives are required to enter into a performance agreement with their responsible Minister for the 2001-02 reporting period. The Chief Executive Performance Agreement will form part of the employment contract between the Premier and the Chief Executive and will be modified at least annually to reflect the changing priorities, strategies and policies of the South Australian Government.

The performance standards or criteria set out in each Chief Executive Performance Agreement will form the basis on which the responsible Minister, with assistance from the Commissioner for Public Employment, will assess the performance of each Chief Executive. The first assessments are planned to commence in July 2002.

These initiatives are designed to ensure improved accountability and foster the achievement and maintenance of a constructive working relationship between a Chief Executive and the responsible portfolio Minister and the Government.

Management and Accountability Frameworks

In recent years the Government has pursued a number of policy and accountability improvement initiatives through formal frameworks applied to government agencies. Of particular note is the Government Management Framework (which commenced in 1997-98), the Financial Management Framework (1998-99) and the Procurement Reform strategy (1998-99). The following outlines progress in relation to the Financial Management Framework (FMF). More detailed discussion regarding the Government Management Framework and the Procurement Reform strategy is provided in 'Government Management and Budget Reforms' and 'Government Procurement of Goods and Services: A Matter of Major Expenditure of Public Monies: A Matter of Continuing Audit Focus' in this Part of the Report.

Financial Management Framework

The FMF provides agencies of government with guidance on the critical processes and controls required for good financial management and accountability practice. It is also fundamental to this Department's audit mandate and audit assessment activity.

The scope of the FMF is extensive and in its first year of implementation Audit considered it reasonable to expect that agencies would take more than one financial year to address all the FMF requirements. Audit observations in 1998-99 and 1999-2000 have been consistent with this view.

In an overall context, Audit observed in 2000-01 that developmental work that was commenced and proceeding within agencies in the previous two years has progressed further. The level of progress, however, has not been substantive in most instances. Only a few agencies have addressed to a satisfactory level most of the integral components of the FMF. Issues that have arisen in agencies regarding the FMF are reported in Part B of this Report.

The introduction and ongoing application of the components of the FMF as a normal part of agency operations must result in improved financial management and accountability practice.

It is important for most agencies to adequately plan to address and resource outstanding issues associated with the implementation of critical aspects of the components of the FMF. Audit will continue to monitor the status of agency developments in this regard.

Audit Committees

In Part A.3 of my 1999 Report to Parliament, I commented that ‘Public governance can be viewed as the complex matrix of relationships that exist … regarding responsibility and accountability for the management and control of public resources and the delivery of programs and services’.

An important element in that matrix of relationships is the establishment by entities of Audit Committees to focus on not only the financial activities of the entity, but also on the management of risk through the operation of adequate and appropriate internal controls.

It is pleasing to observe that there has been a significant increase in the establishment of such committees in the public sector over the past few years in recognition of the role such a committee can play in setting ‘the tone at the top’. It is also pleasing that officers of my Department are frequently invited to attend meetings of these committees as observers. Such involvement of my officers not only assists in developing healthy relationships between the auditor and the auditee, but also provides the auditor with a valuable insight into the expected management culture and management practices of the entity.

Contracting Arrangements

Government and its agencies can enter into contracting arrangements that involve the large outlay of public monies and/or commitments. These arrangements can be diverse in type, activity and complexity.

Over the past few years my Reports have included specific commentary on various aspects of government contracting. One aspect that has been discussed is that of commercial confidentiality and/or public interest confidentiality.

A new Policy on Contract disclosure was released by the Government in May 2001. The Policy is directed to increasing transparency and accountability in respect of the Government’s contracting activities.

Another aspect relates to Audit’s review of certain contractual arrangements of government. As in past years issues arising from the reviews still reveal inadequacies in contract management processes and performance accountability obligations.

Further detailed commentary with respect to these matters is included in this Part of the Report under the heading ‘Contracting Developments: Important Policy, Management and Control Issues: Audit Comment’.

ELECTRONIC GOVERNMENT

Major agency developments are taking place in a fast moving, ever changing technological environment which presents increased management and security control risks, particularly in the emerging area of e-commerce and Internet based service delivery of financial and information services.

Last year I indicated the future direction of this Department in matters concerning electronic commerce (e-commerce).

My coverage of these matters in this year’s Report examines the:

- Government’s implementation of the whole-of-government strategic plan for information technology and associated policy and standards guidance;
- important matters of management, security and control over access to the Government communication network, (StateNet) and the protection of sensitive government information;
- regulatory framework governing e-commerce with a preliminary identification and assessment of some of the risks to Government associated with such activities and, two specific case studies.

The findings indicate the important need for priority to be given to finalisation of the IT Strategic Plan and key policy management guidance and their communication to government agencies. There is a need for effective recognition, coordination and monitoring of key agency initiatives, targeted outcomes and planned achievements to be undertaken.

The review of the StateNet network identified significant weaknesses in a number of important management, design and security matters.

There is also a need for more formal management and reporting arrangements and relevant documentation of major e-commerce initiatives of government.

These matters are reported in this Part of the Report under the headings ‘IT Policy, Management and Control Issues’; ‘SA Government Communications Network (StateNet), Evolution, Functionality and Status regarding Security and Control Arrangements’; and ‘Electronic Government, Legal, Policy, Privacy and Control: Issues of Importance’.

I intend to further review a larger number of e-commerce case studies, agency initiatives and the operation of agency websites that will be the subject of a Supplementary Report in early 2002.

STATUS OF REPORT ON HINDMARSH SOCCER STADIUM REDEVELOPMENT PROJECT

At the date of this Report the report on the Hindmarsh Soccer Stadium Redevelopment Project is in the process of being prepared for printing. It will be presented to the Presiding Officers as soon as this process is completed.

K I MacPherson
AUDITOR-GENERAL

THE STATE'S FINANCES

AND RELATED MATTERS

AN OVERVIEW OF THE STATE'S FINANCES

INTRODUCTION

The 2000-01 year saw the realisation of two significant events that have changed the structure of the State's finances from the past. They are the implementation of national tax reform and the completion of the disposal of the State's electricity assets.

Tax reform offers the prospect of long-term improvement in the revenue base. The magnitude of the change is evident by the fact that Commonwealth general purpose funding increases in 2000-01 by over $855 million. There were also reductions of $573 million from the abolition of some State taxes.

Electricity asset disposals have brought immediate reductions in net debt. Total net proceeds from disposals amounting to $4.9 billion were used for debt retirement. As a consequence there are reductions to interest rate risks and other risks. These are regarded as improving the State's financial position. They come at the cost of disposal of major essential service infrastructure assets and the related income streams.

In past years I have reported on the Government's progress against its financial strategies with the most recent focus being on the four-year plan commencing from the 1998-99 Budget, the first to implement accrual output budgeting. Notwithstanding the accrual perspective, the key budget targets remained cash based. As a result of various changes in the Budget presentation, comparative analysis was limited to the period commencing 1997-98.

This section of the Report overviews some audit observations based on the more detailed work that is set out in the following sections dealing with specific aspects of the State's finances. I refer readers wanting additional details to those sections.

LONG-TERM COMPARABILITY OF DATA

This and past reports have dealt with trend analysis from 1997-98 as various changes to classifications from that time mean that comparative data prior to 1997-98 is not available.

The 2001-02 Budget Papers have a number of key matters that influence long-term trend analysis. Tax reform is one although the nature of the related transitional changes mean that a combination of taxation and Commonwealth general purpose grants will support comparative analysis at an aggregated level.

The other matter is the potential change to the Budget presentation from the cash based non-commercial sector focus to an accrual based Government Finance Statistics (GFS) focus. Data has been prepared for 1999-2000 on the accrual GFS basis but not before. As a consequence, should such a change occur, future trend analysis in many areas will be limited to a period commencing 1999-2000.

THE UNDERLYING BALANCED BUDGET

Since 1994, the annual budget outcome has been a cash based calculation of the sum of all financing transactions, (except provisions)[2] being the difference between recurrent and capital outlays and revenues and grants.

Practice has been that the underlying result excludes major 'one off' items ie of a non-recurring nature and other adjustments that by their size and nature, are abnormal. In 2000-01 the estimated abnormal items are payments of $69 million for targeted voluntary separation packages and costs of $48 million associated with the Government's asset disposals program offset by stamp duty revenue of $39 million from the disposal of electricity assets.

This method of presentation has, and Audit considers properly so, also excluded the net proceeds of the sale of government businesses.

THE 2000-01 ESTIMATED BUDGET OUTCOMES

The following table sets out the key data for the 2000-01 Budget and the estimated result as published in the 2001-02 Budget delivered on 30 May 2001. The actual results are presented in the Budget Results, traditionally tabled in the Spring sitting of Parliament. ***All data is unaudited***.

Comparison of Budgeted and Revised Estimates for the 2000-01 Budget

	2000-01 Budget $'million	2000-01 Estimate $'million	Difference $'million	Difference Percent
Current Outlays	6 326	6 552	226	3.6
Capital Outlays	602	689	87	14.5
Total Outlays	6 928	7 241	313	4.5
Own Source Revenues	2 857	2 976	119	4.2
Grants	3 962	4 112	150	3.8
Total Revenue and Grants	6 819	7 088	269	3.9
Deficit	32	74	42	
Abnormal Items	34	78	42	
Underlying Surplus	2	3	1	

2 This item represents increases in provisions of public trading enterprises included in the non-commercial sector. The provisions relate mainly to depreciation but include provisions for superannuation, long service and recreation leave. The level of increases in provisions is treated as a financing transaction as the corresponding cost, which is a non-cash cost, of the items concerned is included in current/capital government expenditure.

2000-01 Results — Cash Basis

The Estimated Result

Government operations in 2000-01 are estimated to result in a deficit (before abnormals) of $74 million.

After adjusting for abnormals, the underlying result is an estimated surplus of $3 million. This result is derived after a variety of adjustments as discussed below. The 2000-01 Budget estimate was a surplus of $2 million.

Outlays

Estimated outlays total $7.2 billon and are estimated to exceed Budget by $313 million or 4.5 percent. All major components, both current and capital outlays, increased with the exception of net interest payments. Capital outlays are estimated to exceed budget for the first time in a number of years due to better than predicated progress with capital works generally.

Revenues

Revenues total $7.1 billion and are estimated to exceed Budget by $269 million or 3.9 percent. Better than planned revenues were mainly from Commonwealth grants and State taxation. Total revenues exclude budgeted revenue (dividends) of $69.5 million from financial institutions that was deferred to the next year.

Achieving the Budgeted Result

The estimated result for the Budget is determined in the course of preparing the next year's Budget. Established practice has been that where significant changes are expected to materially alter the result from budget, adjustments are made to relevant lines.

A summary of the changes to the 2000-01 Budget incorporated in the revised estimates is detailed in the 2001-02 Budget Papers.[3] Examples are the estimated receipt of unplanned Commonwealth general-purpose grants of $56 million and mining royalties of $32 million.

Without offsetting adjustments, these windfalls would result, all other things being equal, in an improvement to the budgeted surplus. An example of the adjustments the Government made to offset the windfalls was to defer $51 million of a budgeted dividend of $109 million from the South Australian Asset Management Corporation (SAAMC) to the following year.

[3] Budget Statement 2001-02, Budget Paper No. 3, Table 2.3.

The 2000-01 Actual Result

After year-end the final result is determined as agencies finalise their audited accounts. This takes some time after the year end (to indicate the timeframe, the audit of most agencies are completed by 30 September each year).

Similar to the revision process occurring when preparing the next Budget, an estimate of the actual result is made around the time of the year end. Practice has been that in the event the estimate of the actual result varies widely from the revised estimated result, further deferrals of revenue and/or central spending transactions are undertaken to achieve as near the target result as practicable.

At the time of finalisation of the year's result, the Department of Treasury and Finance estimated that, based on agency data, there was a further net improvement from the revised estimate in the order of $124 million against the revised estimated surplus of $3 million. Without adjustment this would result in a surplus in the order of $127 million for the year.

The following further adjustments were made in relation to the final result for 2000-01:

- budgeted revenues of about $81 million have been deferred with SAAMC and the South Australian Government Financing Authority (SAFA) now making no dividend distribution in 2000-01;

- a payment of $30 million was made to SAFA representing a prepayment of interest costs to be incurred in 2001-02. Payments to SAFA represent outlays by the non-commercial sector to the financial institutions sector and are therefore reflected in the surplus.

The final result was not determined at the time of this Report.

Central Transactions

I have made the observation in past years that the Government's ability to determine central transactions at the finalisation of the budget outcome has been a useful facility for the Government to achieve published estimated outcomes. The key point to acknowledge is that the achievement of the cash based budget target is readily accommodated through timing of transactions.

This process means the actual result does not relate to the budgeted flows for a year but rather the actual flows as adjusted to achieve the budgeted result. Over the years this final adjustment process has, in my opinion, become administratively cumbersome. It is presentational and does not affect the overall public sector financial position. For this reason it is important that the estimated and final results are not seen, on their own, as a reflection of the Government's ability to meet its budgeted performance. A sound understanding of the changes in the outlays and revenues comprising the result is, in my opinion, vital to interpreting performance.

I have noted in the section 'The Accrual Budget' that I believe it is imperative for the Government to set out the detail of a revised long-term basis for fiscal strategy and related monitoring and reporting. The GFS accrual basis currently suggested by the Department of Treasury and Finance as an alternative method, in my view, provides a better basis than the current cash based method notwithstanding possible limitations in that reporting framework including the use of sectors. As discussed below, the Budget Papers set out GFS accrual based data. I believe it is necessary for detail to be set out on when this will become the primary basis for Budget presentation and what the specific target/s will be.

I also reiterate my view that whole-of-government reporting is an important reference in understanding the trends and results of public sector financial operations.

2000-01 — Accrual Basis

The 2000-01 Budget[4] set out accrual estimates for the non-commercial sector on an Australian Accounting Standard (AAS) basis.

In 2001-02 the Budget adopted the GFS accrual basis for reporting of accrual information replacing the AAS method. Data is now based on the general government sector, which is different from the non-commercial sector.[5] Comparative information is not available.

Targets for the 2001-02 Budget are discussed later in this section.

2000-01 — Net Debt and Unfunded Superannuation

Two key targets in the Government's current four-year financial plan are the reduction of net debt in real terms and the elimination of the State's unfunded superannuation liability by 2034.

The following table summarises the estimated position as at 30 June 2001 compared to actual for 1999-2000. Data for these items represents both the non-commercial and commercial sectors.

	1999-2000 Actual $'million	2000-01 Estimate $'million	Difference $'million	Difference Percent
Net Debt	4 355	3 270	-1 085	-24.9
Unfunded Superannuation	3 543	3 301	-242	-6.8

Further details are discussed as follows.

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4 Budget Statement 2000-01, Budget Paper No. 2, Table 3.1 and Tables 3.4 to 3.6 delivered May 2000.

5 The general government sector does not include non-commercial public trading enterprises.

Net Debt

Net debt at 30 June 2001 was $3.3 billion a reduction of $1.1 billion from the previous year as a result of the application of proceeds from the disposal of electricity assets to debt retirement.

Unfunded Superannuation Liability

The estimated unfunded superannuation liability as at 30 June 2001 was $3.3 billion. The reduction from the previous year was due mainly to the estimated liability being reduced by $618.5 million based on an actuarial review completed in September 2000. The position as at 30 June 2001 is consistent with the plan to eliminate unfunded superannuation liabilities by 2034.

2001-02 BUDGET

The following table sets out the key data for the 2001-02 Budget and the differences from the estimated results for 2000-01 as published in the 2001-02 Budget.

	2000-01 Estimate $'million	2001-02 Budget $'million	Difference $'million	Difference Percent
Current Outlays	6 552	6 764	212	3.2
Capital Outlays	689	638	-51	-7.4
Total Outlays	7 241	7 402	161	2.2
Own Source Revenues	2 976	2 858	-118	-4.0
Grants	4 112	4 415	303	7.4
Total Revenue and Grants	7 088	7 272	184	2.6
Provisions	79	80	1	
Deficit	74	50	-24	
Abnormal Items	78	52	-26	
Underlying Surplus	3	2	-1	

Further analysis of these movements follows.

2001-02 Budgeted Results — Cash Basis

The 2001-02 Budgeted Result

Government operations in 2001-02 are budgeted to result in a deficit (before abnormals) of $50 million.

After adjusting for abnormals, the underlying result is a budgeted surplus of $2 million.

Outlays

Budgeted outlays total $7.4 billion an increase of $161 million.

The increase derives from a significant increase in final consumption expenditure[6] of $340 million or 7.7 percent. This includes past service superannuation payments of $134 million compared to nil in 2000-01 due to a prepayment in 1999-2000.

Net interest payments decrease by $97 million to $159 million in line with the reduction in net debt in 2000-01.

Revenues

Revenues total $7.3 billion, an increase of $184 million or 2.6 percent.

Commonwealth grants increase by $303 million or 7.4 percent as a result of further changes from taxation reform and an increase in competition payments (refer to the section 'National Competition Policy Implementation Arrangements: Audit Observations and Comments'.

Distributions of $194 million from SAAMC and $110 million from SAFA are proposed. This is the largest total contribution from these two entities over the period of the forward estimates and does not represent ongoing sustainable distributions. Notwithstanding the revised estimate for 2000-01, these entities made no dividend distributions in 2000-01 as was the case for the previous two years.

Forecast Results — 2002-03 to 2004-05

The following table sets out the key data as published in the 2001-02 Budget.

Forward Years 2002-03 to 2004-05

	2002-03 Estimate $'million	**2003-04 Estimate $'million**	**2004-05 Estimate $'million**
Current Outlays	6 790	6 941	7 115
Capital Outlays	570	571	543
Total Outlays	7 360	7 512	7 658
Own Source Revenues	2 747	2 796	2 846
Grants	4 532	4 635	4 732
Total Revenue and Grants	7 279	7 431	7 578
Provisions	82	82	82
Surplus	2	1	3
Abnormal Items	-	-	-
Underlying Surplus	2	1	3

6 Final consumption expenditure comprises mainly salaries and wages and supplies and services.

Of crucial importance is whether the means by which forecast outcomes to 2004-05 are achieved can be sustained in the long term and not be the result of continuous balancing from one-off adjustments, in particular, large, ad hoc, receipts from within Government.

The following observations are, I believe, relevant in this regard.

Persistent Past Deficits (Before Adjusting for Abnormals)

Firstly, the forecast outcomes, underlying balanced results through to 2004-05 are Government policy targets. This is the basis on which forecasts are prepared.

Audit has not assessed the individual components of the forward estimates. However, to give a perspective to the forward estimates, it is useful to reflect on past results.

The collective reported result for the four years 1997-98 to 2000-01 for the non-commercial sector was a deficit (before adjusting for abnormals) totalling $119 million, which has been financed by an increase in net debt. It is important to note that abnormal items include separation payments which are aimed at structural improvements in the Budget in the longer term.

Included in this period was a surplus of $150 million in 1997-98 based on a return of capital of $150 million from SAFA. This was simply a transfer of assets between sectors of Government and did not improve the total public sector financial position.

After 1997-98, the actual results (before abnormals) for each of the three years 1998-99 to 2000-01 were deficits. Each year the actual deficits (before abnormals) exceeded budget.

I have already mentioned that given its derivation, the cash result for a year should not be regarded in isolation. It is, however, notable that in recent history projected outcomes have not been achieved and in fact, persistent, higher than budgeted deficits have been incurred.

Internal Transfers and Use of Reserves

The forward estimates include the receipt of further, lumpy distributions from SAAMC and SAFA as has been the practice in past Budgets. For the last three years, notwithstanding the large amounts budgeted, (for example $200.6 million was the budgeted distribution from SAAMC in 1999-2000), no distributions have been required.

The nature of the budgeted transfers is that they are essentially distributions of capital. SAAMC and SAFA do not have the capacity to earn profits of the order of the budgeted distributions and their profitability is projected to reduce as their capital reduces. As a consequence they do not represent ongoing sustainable distributions.

There can be no argument that the use of reserves would be expected to occur periodically, given that the State's revenues are tied to national economic conditions[7] or because there may be particular, lumpy outlays periodically. The budgeted draw on SAAMC and SAFA, however, reduce their reserves from about $600 million in 2000-01 to less than $200 million over the four years to 2004-05.

Should such distributions be required (and as noted they have not in the past) then it will be important to understand the purposes for which reserves are used. Where their use is for recurrent purposes, it should be explicitly for one-off or time limited expenditures to the extent practical. If this is not the case, the sustainability of the related outlays may be questioned. It is also important, in my opinion, to understand the prospects of rebuilding reserves at a later date.

Controlling Outlays

The main component of outlays, final consumption expenditure, adjusted to exclude superannuation and abnormals, continues to grow in real terms, albeit slowly over the forward estimate period.

The State has done two key things in recent years that were aimed at directly influencing outlays that are included in final consumption expenditure, namely salaries and wages and supplies and services. They are the reduction of the public sector workforce by some 22 000 targeted separations since 1991-92 and the outsourcing of services that are responsible for large amounts of outlays.

The fact that the budget forward estimates show final consumption expenditure growing in real terms is a realistic assumption. In total, however, outlays are projected to decrease in real terms from 2001-02. Audit analysis indicates that this is against the trend for the four years to 2001-02 where outlays[8] have increased annually in real terms. This suggests that managing the level of outlays will be essential to achieve set targets.

National Tax Reform Arrangements

An as yet unknown, but projected longer-term benefit to the State's finances, is the commencement of national tax reform arrangements. The projected benefits are, however, currently not projected to commence until 2006-07.

Managing Performance

Overall, the Budget does not indicate much flexibility over the forward estimates period in cash terms or when considering the accrual results discussed below.

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7 See discussion of revenue risks Budget Statement 2001-02, Budget Paper No. 3, pp. 9.4 to 9.6.

8 Outlays reviewed by Audit are adjusted to exclude Commonwealth specific purpose payments and abnormal items.

The projection of real decreases in outlays and total revenues over the forward period, when compared to the recent history for outlays, emphasises the need for managing the actual performance against budget and for control of spending the State's resources. In the longer term, the Government anticipates that South Australia will gain from tax reform from 2006-07 and that benefits will derive from the fact that the Goods and Services Tax is a genuine growth tax.[9]

2001-02 Budgeted Results — Accrual Basis

The 2001-02 Budget[10] again sets out accrual estimates notwithstanding that the primary targets are cash based. The data is prepared on the basis of the recently adopted accrual GFS method. It was previously prepared on the AAS accrual based method. The scope of coverage for the GFS accrual data focuses on the ABS general government sector. That sector excludes non-commercial public trading enterprises that are included in the non-commercial sector.

The following table sets out the key data for the 2000-01 Budget and the estimated result as published in the 2001-02 Budget. The terms used in the GFS presentation are discussed in the section of this Report 'The Accrual Budget'.

Accrual GFS Data for the General Government Sector (Nominal Terms)

	2000-01 Estimate $'million	2001-02 Budget $'million	Difference $'million	Difference Percent
GFS Revenue	7 880	8 141	261	3.3
GFS Expenses	8 101	8 179	78	1.0
GFS Net Operating Balance	-221	-38	183	
GFS Borrowing	-346	-209	137	
Assets	23 041	23 210	169	0.7
Liabilities	9 718	9 837	119	1.2
Net Worth	13 323	13 373	50	0.4
Net Financial Assets	3 832	3 661	-171	-4.5

The key points from the data are:

- outlays grow at a lesser rate than revenues with the result being a significant decrease in the net operating deficit for 2001-02.
- the GFS borrowing requirement, representing the amount by which capital spending net of depreciation expense is met from net operating revenues, remains high at $209 million in 2001-02 notwithstanding a $137 million improvement from the previous year.

9 Budget Statement 2001-02, Budget Paper 3, p. 6.18.

10 Budget Statement 2001-02, Budget Paper No. 3, Chapter 3 'The Accrual Budget Perspective'.

Forecast Results — 2002-03 to 2004-05

The following table sets out the key data as published in the 2001-02 Budget.

Forward Years 2002-03 to 2004-05

	2002-03 Estimate $'million	2003-04 Estimate $'million	2004-05 Estimate $'million
GFS Revenue	8 194	8 319	8 470
GFS Expenses	8 174	8 314	8 387
GFS Net Operating Balance	19	4	83
GFS Borrowing	111	130	61
Assets	23 562	23 956	24 406
Liabilities	10 097	10 404	10 693
Net Worth	13 465	13 553	13 714
Net Financial Assets	3 594	3 549	3 613

The key points from the data are:

- an operating surplus is projected from 2002-03 through to the end of the forward estimate period 2004-05;
- the GFS borrowing requirement is projected to improve annually but not be eliminated by the end of the forward estimates. In 2004-05 a borrowing requirement of $61 million is projected. This means that the Government anticipates it will have to continue to borrow money for at least the next four years to fund total cash outlays;
- net worth increases across the forward years;
- net financial assets decrease in both 2002-03 and 2003-04 but increase in 2004-05.

2001-02 Net Debt and Unfunded Superannuation

The estimated results for these key targets (non-financial public sector) in the Government's current financial plan are as follows.

	2000-01 Estimate $'million	2001-02 Budget $'million	Difference $'million	Difference Percent
Net Debt	3 270	3 392	122	3.7
Unfunded Superannuation Liabilities	3 301	3 399	98	3.0

Net Debt

Net debt at 30 June 2002 is estimated at $3.4 billion an increase of $122 million from the previous year as a result of projected deficits for 2001-02 in both the non-commercial ($50 million) and commercial ($66 million) sectors.

Unfunded Superannuation Liability

The estimated unfunded superannuation liability as at 30 June 2002 is $3.4 billion. The increase reflects the fact that the unfunded liability is expected to continue to increase until 2018-19 in line with the plan to fund this liability over the period to 2034.

A COMMENTARY ON THE STATE'S BUDGET: FROM 1997-98 UP TO AND INCLUDING THE FORWARD ESTIMATES FOR THE YEAR 2004-05

INTRODUCTION

This section provides an analysis of, and comments on, in aggregate terms, trends and key factors in the State's Budget since 1997-98 including the forward estimates up to the year 2004-05 published as part of the State's Budget for 2001-02. The analysis is based on Government Financial Statistics (GFS)[11] data for the non-commercial sector, consistent with the principal emphasis in the Government's Budget presentation.

The Budget — A Financial Management Process

The importance of the budget process is that it provides structure and discipline to the financial management process. That process is a necessary element for adequate control over the State's finances. The Government has used the cash based non-commercial sector as its focus of the fiscal strategy since the recommendations of the Commission of Audit in 1994. The key to the strategy has been for the non-commercial sector to be able to live within the cash resources available to it in each year of a four year budget cycle. These aims have been focussed on a key performance indicator, that is, achieving an underlying balanced budget.[12] This is the 'headline' result.

Recent Experiences — Achieving Budget Targets

In recent years annual outlays have been within available resources due to delays in capital spending and/or additional unplanned revenues being received. To achieve the Budget targets, the Government has deferred other revenues and brought forward other payments. For the most part, such transactions are simply presentational. The Government considers the 'headline' result is important in managing the public face of the Budget. To most readers deficits look bad, surpluses, in a public sector environment, look like missed opportunities to spend further. In Audit's opinion, these are better regarded as matters to be explained over a cycle (rather than one year) to allow for unplanned impacts.

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11 The cash based GFS basis provides for some offsetting of recoveries against outlays. The key areas of importance are; the offsetting of sales of goods and services against general government final consumption expenditure; the offsetting of capital repayments/recoveries against the item 'Advances'; the offsetting of asset sales proceeds (excluding sale of government businesses) from capital outlays.

12 The 'underlying' result is after abnormal items. In fact targets have been very small surpluses — $1 million to $2 million. Audit has characterised this as balanced.

The key point to acknowledge is that the achievement of the cash based budget target is readily accommodated through timing of transactions. In these circumstances the structural soundness of the budget is a more important element than the 'headline' result. The Government is currently considering future fiscal targets. A related discussion of fiscal targets is addressed in the section of this Part 'The Accrual Budget'.

AUDIT APPROACH

The approach taken in the analysis is to provide detail on certain of the budget data and to provide a time series where possible to assist in trend identification. ***In particular, all analysis in this section is net of Commonwealth specific purpose payments.*** There are also some adjustments of aggregates to focus on trends without the influence of items such as abnormals, interest and superannuation payments. This is similar to data available in the Budget Papers[13] and it is considered that the Budget Papers provide detail supporting an understanding of the State's finances and position.

Limitations on Analysis

An analysis of budget and long-term data is affected by a number of factors. For example, notwithstanding its recent release in May 2001, there are already changes to components of the 2001-02 Budget. Further, the figures for 2000-01 are revised estimates for the year rather than actual data. Indeed, at the time of this Report, as indicated in the 'Overview of the State's Finances', there were some substantial changes to the estimated results for 2000-01 such that there was the potential for a larger surplus than anticipated in the 2001-02 Budget. Data is also affected by changes in classifications and State-Commonwealth funding arrangements from year to year. Finally discretionary changes to planned outlays as has occurred with past superannuation payments make trend analysis more difficult requiring users to be aware of the related causes and implications of such changes.

Overall, in Audit's view these adjustments are not so great as to invalidate the overall trend analysis from the Budget data, ie it is generally within reasonable limits. It may be the case that some of the disaggregated analysis can be affected by differences between actual results and estimated results. Where possible this is acknowledged in the text.

SUMMARY OF THE AUDIT ANALYSIS OF CHANGES OVER THE PERIOD 1997-98 TO 2004-05

1997-98 to 1999-2000

In these three years the actual underlying results were:

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13 For example 'Budget Statement 2001-02 Budget Paper 3' Table 2.1.

Year	$'million
1997-98 Surplus	48
1998-99 Deficit	55
1999-2000 Deficit	25

Outlays grew over this period, through final consumption expenditure in 1998-99 and then capital outlays in 1999-2000.

In 1999-2000 it was deemed necessary to extend the period for fully funding superannuation liabilities by 10 years to 2034 (it was then in line with Victoria and NSW plans) — this saved about $55 million per annum in outlays.

Revenues matched outlay growth with strong increases in taxation and Commonwealth receipts.

In arriving at the reported results, account was taken of delays in some outlays particularly capital outlays, and better than budgeted revenue outcomes from State taxes and Commonwealth grants. Given the cash basis used, these outcomes were offset by various adjustments involving bringing forward certain superannuation payments otherwise budgeted to be made at later dates and deferring revenues from financial institutions thereby evening out the result from year to year. But for these changes, the results in prior years would have presented substantially differently — perhaps a higher surplus in one year and a deficit in another/the next. As the transactions were due primarily to timing and between different sectors of government, there was no change to the whole-of-government position.

2000-01 and 2001-02

For 2000-01 and 2001-02 it is again forecast that the balanced underlying budgets will be achieved.

The estimated result for 2000-01 reports substantial increases in all outlay items other than net interest when compared to both 1999-2000 and the budget for 2000-01. These increases were again matched by better than budgeted revenue outcomes for tax receipts and Commonwealth general purpose grants. Advice from the Department of Treasury and Finance is that the most recent estimate confirms that the targeted result will virtually be achieved. Outlays are again within resources allowing some final adjustments deferring budgeted distributions from SAAMC and SAFA and bringing forward payments support this outcome.

Total outlays peak in 2001-02. In particular, past service superannuation payments in 2001-02 are estimated to be $134 million after being nil in 2000-01. The estimated underlying balanced result for 2001-02 is achieved after budgeting for substantial distributions (a total of $304 million) from the reserves of the South Australian Asset Management Corporation (SAAMC) and the South Australian Government Financing

Authority (SAFA).[14] While it has been noted in the past that such distributions are used at least in part for capital outlays slippage, the amount of distributions does not coincide with an unusually high capital program in 2001-02.

The Forward Years 2002-03 to 2004-05

Again balanced underlying budgets are forecast. This is consistent with budget practice over a number of years. Of note is the projection that both outlays and revenues will fall in real terms over the forward years. This is to be compared to the outcomes in the previous years discussed where real increases in outlays occurred or are projected. The major item expected to reduce is capital outlays. Final consumption, by comparison, is projected to increase in real terms over the whole of the period reviewed, except for 2002-03. This is unsurprising given that the main cost is salaries and wages.

In relation to revenues, further distributions amounting to $201.5 million from the reserves of SAAMC and SAFA are forecast for the forward estimate years.

Some Concluding Observations

Budget Forecasts

The 2001-02 Budget forecasts underlying balanced results as have earlier budgets. Experience to date is that the budgeted results on a cash basis are essentially achieved. Discretionary adjustments are undertaken to ensure the result is as close as practicable to the budgeted 'headline' result. This has again occurred for 2000-01.

For the immediate year, 2001-02, substantial increases in both outlays and revenues are anticipated. In the forward years, real reductions in outlays are projected in line with the expected completion of some capital works and reduction of subsidies and other payments. Within total outlays, final consumption expenditure is expected to increase in real terms.

The outlay trends are matched by revenue trends. Within total revenues, of the two key revenue items, taxation receipts are projected to rise in real terms while Commonwealth general-purpose grants are projected to be steady over the forward estimates. It is notable that outlay increases experienced to date have been covered by better than budgeted performance by taxation receipts and Commonwealth general-purpose grants. It is of course possible that this will not occur in any particular year given that revenue performance is subject to the influence of economic conditions. This prospect heightens the importance of controlling outlays within targets. Importantly, the Budget continues to incorporate provisions for unplanned outlays and emerging priorities that will assist in this management task.

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[14] As mentioned later in this section, a Department of Treasury and Finance review has determined that SAFA's capital should be reduced in line with its needs.

Distributions from Reserves

The other matter of some significance to past Budgets is that large distributions from the reserves of SAAMC and SAFA have been projected in most Budgets but have been deferred in most cases, generally because they were not needed to achieve target Budget results. In fact there have been no distributions since 1997-98 other than income tax equivalents. The 2001-02 Budget projects distributions totalling $505.5 million over four years with $304 million in 2001-02. Such distributions are, in my opinion, unsustainable, as these entities have no capacity to replace amounts of this magnitude going forward.

Managing Performance

Overall, while the characteristics of the 2001-02 Budget are in line with many before it, the projection of real decreases in outlays and total revenues over the forward period, when compared to the recent history for outlays, emphasises the need for managing the actual performance against budget and for control of spending the State's resources. In the longer term, the Government anticipates that South Australia will gain from tax reform from 2006-07 and that benefits will derive from the fact that the Goods and Services Tax is a genuine growth tax.[15]

OVERVIEW OF DETAILED BUDGET AND ACTUAL INFORMATION

Outlays, Revenues and the Underlying Result — Tables

The following tables (nominal terms), provided by the Department of Treasury and Finance set out the detailed aggregates considered in this section of the Report. In the second table, used for most of the Audit commentary and analysis, the receipt and expenditure of Commonwealth specific purpose payments has also been removed. The elimination of these specific purpose payments allows the analysis to focus on the effects of State decision-making.

It is to be noted that the 'Abnormal Items' shown in the Tables, and on which the calculation of the 'Underlying Deficit' figures are based, are as identified by the Department of Treasury and Finance.

The presentation that follows is in accordance with the GFS framework as discussed in the introduction section and related footnote.

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15 Budget Statement 2001-02, Budget Paper 3, p. 6.18.

Non-Commercial Sector (Nominal)

(Excludes Net Proceeds of the Sale of Government Businesses)

	Actual 1997-98 $'million	Actual 1998-99 $'million	Actual 1999-2000 $'million	Budget 2000-01 $'million	Estimated Result 2000-01 $'million	Budget 2001-02 $'million	Estimate 2002-03 $'million	Estimate 2003-04 $'million	Estimate 2004-05 $'million
Current Outlays									
General government final consumption expenditure	3 845	4 232	4 332	4 316	4 402	4 742	4 815	4 978	5 170
Net interest payments	640	539	456	347	256	159	177	158	161
Subsidies paid	483	550	618	659	776	733	668	661	648
Other (a)	800	877	945	1 003	1 118	1 131	1 130	1 144	1 135
Total Current Outlays	5 768	6 198	6 351	6 325	6 552	6 765	6 790	6 941	7 114
Capital Outlays									
Gross fixed capital expenditure and other capital outlays	394	322	515	561	602	612	535	539	545
Grants	3	23	24	74	80	46	45	41	11
Advances	-182	-15	-46	-33	7	-20	-10	-9	-13
Total Capital Outlays	215	330	493	602	689	638	570	571	543
Total Outlays	5 983	6 528	6 844	6 927	7 241	7 403	7 360	7 512	7 657
Own Source Revenues									
Taxes	2 297	2 504	2 745	2 089	2 172	1 984	2 068	2 146	2 227
Net operating surplus of non-commercial public trading enterprises	87	109	119	59	118	29	28	34	35
Income from commercial public trading enterprises			377	279	247	243	256	262	273
Other revenue	781	655	279	430	438	602	395	354	312
Own Source Revenues	3 165	3 268	3 520	2 857	2 975	2 858	2 747	2 796	2 847
Grants Received	2 894	3 052	3 203	3 962	4 112	4 415	4 532	4 635	4 732
Total Revenue and Grants Received	6 059	6 320	6 723	6 819	7 087	7 273	7 279	7 431	7 579
Financing Transactions									
Provisions	74	75	60	77	79	80	82	82	82
Deficit/(Surplus)	-150	133	61	31	75	50	-1	-1	-4
Abnormal Items									
Stamp duty on electricity sales/leases			103		39	0	0	0	0
Separation payments	-41	-51	-68	-20	-69	-40	0	0	0
Cost associated with asset sales	-9	-27	-70	-14	-48	-12	0	0	0
SAFA return of capital	150								
UNDERLYING DEFICIT/(SURPLUS)	-48	55	26	-3	-3	-2	-1	-1	-4

(a) Grants on-passed to Local Government, personal benefit payments etc.

Non-Commercial Sector (Nominal)

(Excludes Net Proceeds of the Sale of Government Businesses and Revenue and Expenditure in relation to Commonwealth Specific Purpose Payments)

	Actual 1997-98 $'million	Actual 1998-99 $'million	Actual 1999-2000 $'million	Budget 2000-01 $'million	Estimated Result 2000-01 $'million	Budget 2001-02 $'million	Estimate 2002-03 $'million	Estimate 2003-04 $'million	Estimate 2004-05 $'million
Current Outlays									
General government final consumption expenditure	2 933	3 358	3 395	3 373	3 453	3 756	3 805	3 940	4 111
Net interest payments	640	539	456	347	256	159	177	158	161
Subsidies paid	442	495	553	598	716	659	602	592	578
Other (a)	486	521	548	627	673	662	660	662	642
Total Current Outlays	4 501	4 912	4 952	4 945	5 098	5 237	5 244	5 353	5 492
Capital Outlays									
Gross fixed capital expenditure and other capital outlays	296	220	446	513	534	552	465	471	477
Grants	3	17	16	66	72	38	37	33	3
Advances	-182	-15	-46	-33	7	-20	-10	-9	-13
Total Capital Outlays	117	222	416	546	613	570	492	495	467
Total Outlays	4 618	5 134	5 368	5 492	5 711	5 807	5 736	5 848	5 959
Own Source Revenues									
Taxes	2 297	2 504	2 745	2 089	2 172	1 984	2 068	2 146	2 227
Net operating surplus of non-commercial public trading enterprises	87	109	119	59	118	29	28	34	35
Income from commercial public trading enterprises	0	0	377	279	247	243	256	262	273
Other revenue	781	655	279	430	438	602	395	354	312
Own Source Revenues	3 165	3 268	3 520	2 857	2 975	2 858	2 747	2 796	2 847
Grants Received	1 529	1 658	1 727	2 527	2 582	2 819	2 908	2 971	3 034
Total Revenue and Grants Received	4 694	4 926	5 247	5384	5 557	5 677	5 655	5 767	5 881
Financing Transactions									
Provisions	74	75	60	77	79	80	82	82	82
Deficit/(Surplus)	-150	133	61	31	75	50	-1	-1	-4
Abnormal Items									
Stamp duty on electricity sales/leases	0	0	103	0	39	0	0	0	0
Separation payments	-41	-51	-68	-20	-69	-40	0	0	0
Cost associated with asset sales	-9	-27	-70	-14	-48	-12	0	0	0
SAFA return of capital	150	0	0	0	0	0	0	0	0
UNDERLYING DEFICIT/(SURPLUS)	-48	55	26	-3	-3	-2	-1	-1	-4

(a) Grants on-passed to Local Government, personal benefit payments etc.

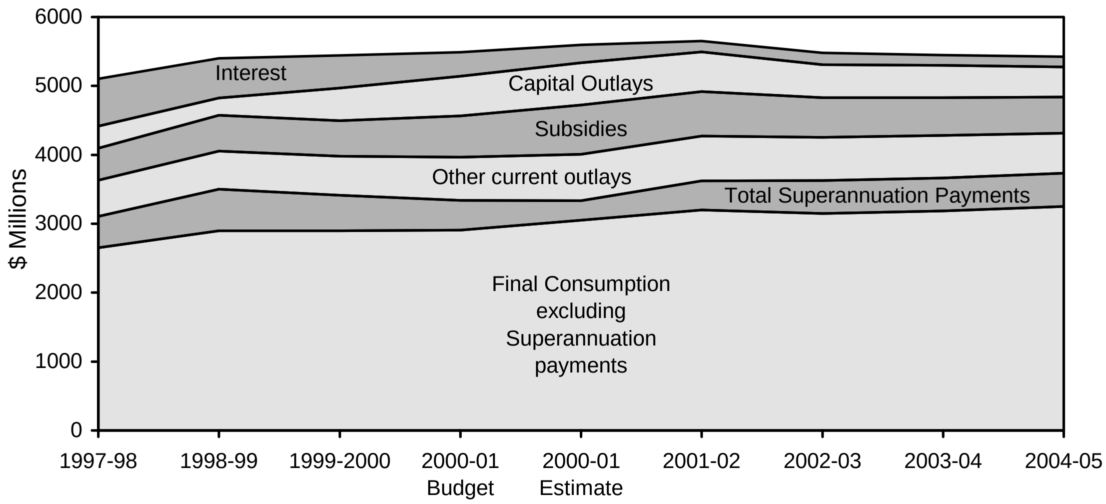
The following Audit commentary relates to specific factors that influence the trends shown by the data. This process aims to assist readers' understanding of significant components rather than restate the underlying deficit calculation.

It is also repeated that the above figures for 2000-01 and later years and the analysis that follows are based on the Government's budget estimates. Past experience shows that actual outcomes may differ substantially from estimates.

OUTLAYS

The following chart highlights the trends in outlays that have emerged since 1997-98. All outlay data is adjusted to be net of Commonwealth Specific Purpose Payments and abnormal items.

Non-Commercial Sector Real Outlays (Adjusted)



This presentation highlights those items that are lumpy, discretionary or, in the case of interest payments, have changed significantly over time.

The following observations arise from the trends in the data.

CURRENT OUTLAYS

General Government Final Consumption Expenditure

Final consumption expenditure is by far the largest component of State outlays being 65 percent of outlays in 2001-02. It represents a net figure that is derived from the total of expenditure by government agencies on wages and salaries, purchases of goods and services and employer contributions to superannuation schemes less the value of sales of goods and services provided by government agencies.

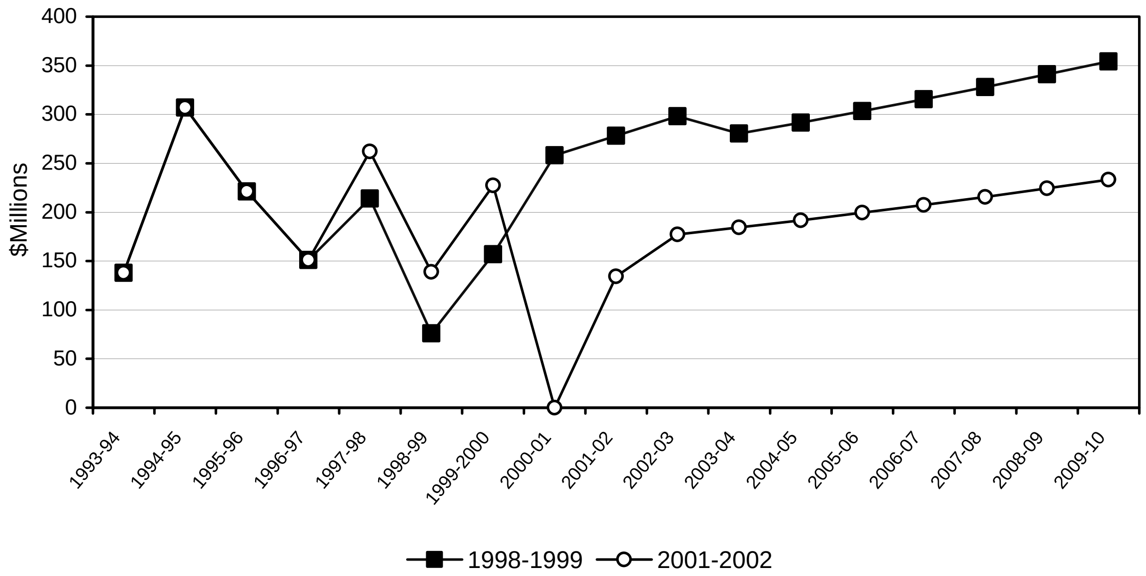
Three particular aspects — superannuation funding, separation packages, and the cost of asset sales — are discussed in turn. Provisions for contingencies are also discussed.

Superannuation Funding

Total superannuation funding is a significant part of outlays, it is estimated to be 11.6 percent of final consumption (excluding Commonwealth amounts) in 2001-02. Payments comprise amounts paid from the non-commercial sector as contributions with respect to current employment new service and contributions reflecting lack of funding for current employment in previous years (‘past service’ contributions).

Total superannuation payments have tended to vary widely from year to year and from budgeted figures due to the use of these payments to cover underspending in other years. The following chart highlights this fact. It represents past superannuation payments as budgeted in the 1998-99 Budget and in the 2001-02 Budget.

Past Service Superannuation Payments Actual and Estimated (a)



(a) Data from 1993-94 to 1999-2000 actual and budget. Data for 2000-01 estimated result. Data from 2001-02 to 2009-10 budget.

Apart from the annual variability up to 2001-02, the reason for the subsequent difference between budgets is an extension of the time frame to eliminate the unfunded superannuation liability from 30 years to 40 years (from 2024 to 2034) — announced in the 1999-2000 Budget and a further reduction in scheduled payments from 2004-05 based on an actuarial assessment which resulted in a material reduction in the estimated liability as at 30 June 2001.

Audit’s approach, so as to obtain a meaningful picture of developments over time, has been to deduct from the figures for total superannuation funding from the non-commercial sector, the amounts paid as benefits so as to obtain consistent measures, over time, of the net contribution by the non-commercial sector to the funding of superannuation liabilities currently accruing or which have accrued in the past. The following table has been prepared with this in mind.

Superannuation Funding from Non-Commercial Sector

	(1) Total Funding $'million	(2) Benefits Paid (a) $'million	(3) Net Contribution Liabilities (b) $'million	(4) Real (June 2001) Terms (c) $'million
1993-94	545	280	265	304
1994-95	583	284	299	331
1995-96	595	285	310	335
1996-97	459	270	189	204
1997-98	423	282	141	151
1998-99	566	308	258	274
1999-2000	498	327	171	176
2000-01 Budget	433	321	112	112
2000-01 Estimated Result	286	340	-54	-54
2001-02 (d)	434	364	70	69
2002-03 (d)	504	392	112	107
2003-04 (d)	517	417	100	93
2004-05 (d)	530	443	87	79

(a) Met from non-commercial sector in 1993-94 and from the Superannuation Funds Management Corporation (Funds SA) in subsequent years. Does not include benefits paid from employees' contributions.

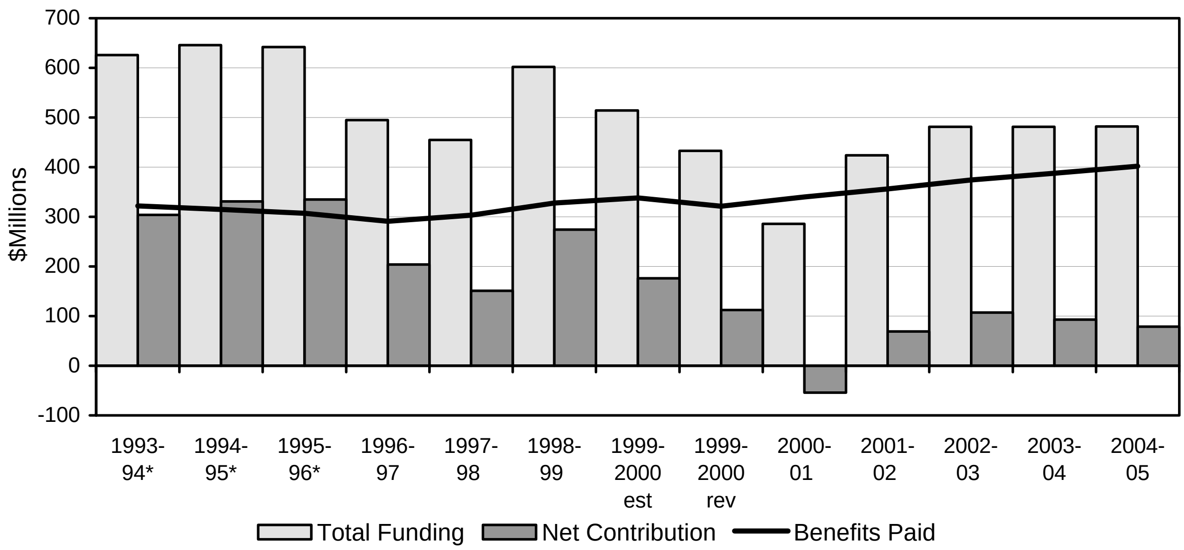
(b) Net contribution to past and currently accruing liabilities, that is, column (1) minus column (2).

(c) Deflators as provided by the Department of Treasury and Finance.

(d) Estimates/projections included in the 2000-01 Budget.

The following chart shows the trends in total funding, benefits paid and net superannuation contributions in real terms over the period of the table.

Superannuation Benefits and Contributions (Real)



It will be seen that:

- In real terms total funding for superannuation has decreased over the period reviewed. The amount included in the 2001-02 Budget forward estimates is below the pre 1998-99 levels, especially. This is consistent with the change in the 1999-2000 Budget to extend the period of eliminating superannuation liabilities to 2034.

- Benefit payments increase over the forward estimate period resulting in decreasing net contributions to funding of superannuation liabilities currently accruing or which have accrued in the past. Benefit payments for the major schemes (State and Police) are currently estimated to peak in 2018-19.

The preceding data show the current position and are influenced by the payments made to meet the unfunded superannuation liability and the pattern of benefit payments.

The reduction in the level of total payments for superannuation including the extension of the timeframe to fund superannuation liabilities to 2034 and the actuarial assessment reducing the estimated total liability, have enabled reductions in estimated future payments and provided additional room for spending in other areas, while staying within total outlay projections.

Overall, it is estimated that the Government's plan to fully fund superannuation liabilities by 2034 remains on track. Further discussion in relation to superannuation funding is provided in the section in this part of the Report titled 'State Debt and Other Liabilities'.

Separation Packages

Separation payments continue to be a feature of workforce management with spending estimated to be $69 million in 2000-01 and $40 million in 2001-02. The Department of Treasury and Finance has consistently recognised these payments as an abnormal item in the Budget each year for a number of years.

Where these payments related to public trading enterprises, they are recorded under the item Subsidies Paid. This occurred in 1999-2000 in relation to TransAdelaide employees.

Cost of Asset Sales

The estimates included in the 2001-02 Budget have allowed for costs associated with asset sales which peaked at $70 million in 1999-2000 when the majority of the electricity asset disposals were finalised. These are identified as 'abnormal items'. To obtain expenditure data on a comparable basis over time it is necessary to 'add back' these amounts.

Contingencies for Supplies and Services and Plant and Equipment

The estimates for 2001-02 and beyond provide quite large amounts 'to provide Government with funding capacity to meet unplanned cost pressures and new high priority initiatives as they emerge' over the forward estimates period. $64 million is set aside for 2001-02 for supplies and services and $17.6 million for the purchase of plant and equipment.[16]

In 2000-01 about 50 percent of the total amounts set aside for the four year estimates period 2000-01 to 2003-04 was applied to various purposes.

An amount, in line with the annual contingency amounts in the 2000-01 Budget, was again set aside in the 2001-02 Budget for the estimates period to 2004-05 being the uncommitted amounts to 2003-04 and an additional amount for 2004-05.

Public Sector Wage Growth

Public sector wages represent a very high proportion of the total current outlays. The 2001-02 Budget provides sums for anticipated public sector wage increases over the forward estimates period. The amount identified is the Government's estimate of what is needed to meet reasonable but realistic wage outcomes over the forward estimate period. $31.9 million is set aside for 2001-02.[17] Enterprise agreements concluded in the course of 2000-01 were fully funded by transfers from the contingency provisions.

Final Consumption Expenditure on a Comparable Basis

The following table adjusts the data for three of the factors referred to above.

General Government Final Consumption Expenditure

	(1) Total Expenditure $'million	(2) Superannuation Funding $'million	(3) Separation Packages $'million	(4) Cost of Sale of Assets $'million	(5) Net Expenditure in Real Terms (a) $'million
1997-98	2 933	423	33	9	2 653
1998-99	3 358	566	43	27	2 898
1999-2000	3 395	498	16	70	2 899
2000-01 Budget	3 373	433	20	14	2 906
2000-01 Estimated Result	3 453	286	69	48	3 050
2001-02 (b)	3 756	434	40	12	3 199
2002-03 (b)	3 805	504	-	-	3 147
2003-04 (b)	3 940	517	-	-	3 184
2004-05 (b)	4 111	530	-	-	3 252

(a) Based on deflators provided by the Department of Treasury and Finance; data in 2000-01 terms.
(b) Projections in 2001-02 Budget.

The following table shows how these expenditures, after adjustment, have changed or are forecast to change from year to year.

16 Portfolio Statements 2001-02, Budget Paper 5, Volume 1, p. 3.23 and 3.25.

17 Portfolio Statements 2001-02, Budget Paper 5, Volume 1, p. 3.23

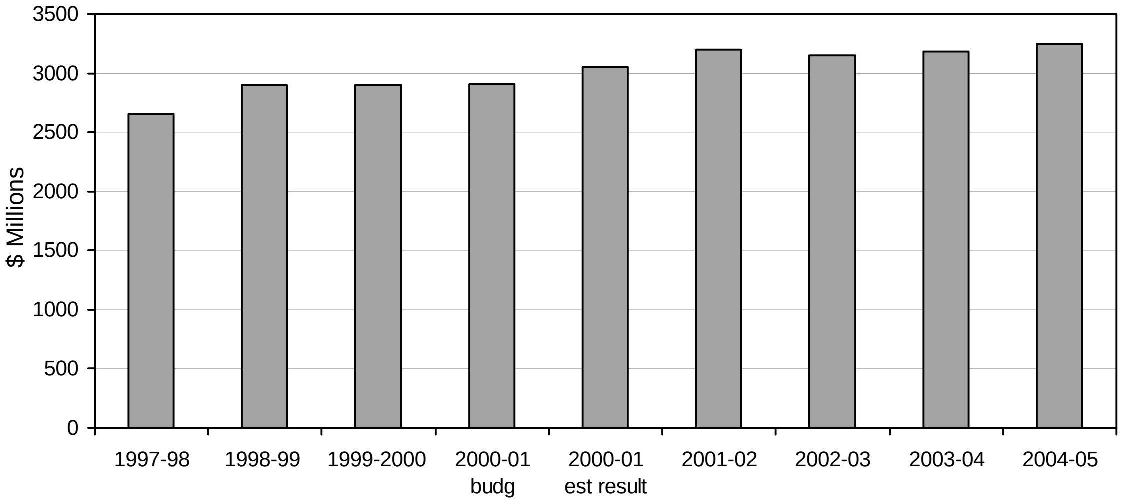
General Government Final Consumption Expenditure as Adjusted
Increase Over Previous Year

	Nominal Terms Percent	Real Terms* Percent
1997-98	-	-
1998-99	10.3	9.2
1999-2000	3.3	0.0
2000-01 Budget	3.4	0.2
2000-01 Estimated Result	8.5	5.2
2001-02	7.2	4.9
2002-03	0.9	-1.6
2003-04	3.7	1.2
2004-05	4.6	2.1

* Deflators as provided by the Department of Treasury and Finance.

The following chart shows the trend in general government final consumption expenditure (as adjusted) over the period of the table.

Adjusted Final Consumption Expenditure (Real)



It will be seen that, on the basis of this data:

- there is a very marked increase from 1997-98 to 2001-02 including an increase of $151 million in real terms in the 2000-01 estimated result over 1999-2000 noting that actual results for 2000-01 have not been finalised;
- the 2001-02 Budget incorporates a further increase of $149 million or 4.9 percent in real terms from 2000-01;
- the forward estimates for the subsequent years show a decrease in 2002-03 and then continuing increases in expenditure in real terms;
- total outlays in 2004-05 are estimated to be $599 million or 22.6 percent higher than 1997-98. Most of this increase occurs up to 2001-02.

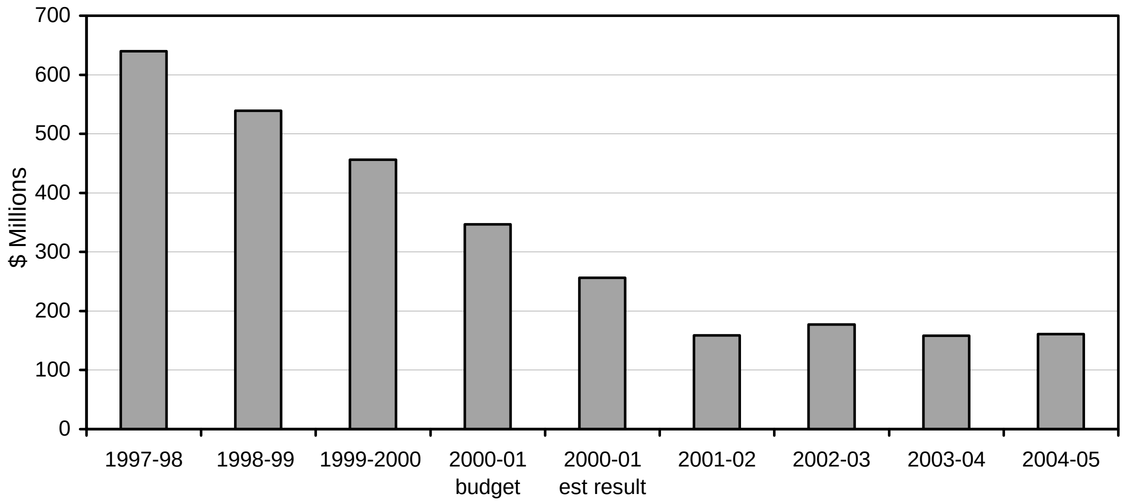
In summary, the key component of total outlays has or is estimated to maintain a trend of growth across the entire period reviewed. This data, while calculated on a slightly different basis, is consistent with the 2000-01 Budget Papers.[18]

Net Interest Payments

The estimates indicate a very large decrease expected in the net interest payments for 2000-01 and again 2001-02 resulting from reductions in debt following the finalisation of electricity asset disposals in 2000-01. While reducing outlays, this is at the cost of revenues foregone from asset disposals.[19]

The trend in net interest payments is highlighted in the following chart.

Change in Net Interest Expense



Net interest payments level out over the forward estimates period following the conclusion of the electricity asset disposal process and the fact that balanced budgets are planned thus little change in debt is expected. Further discussion in relation to debt movements is provided in the section in this Part of the Report titled ‘State Debt and Other Liabilities’.

Other Current Outlays

This category comprises current expenditure other than final consumption expenditure and interest payments. It includes subsidies of various kinds, grants to local government, and personal benefit payments.

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18 Budget Statement 2001-02 Budget Paper 3, Table 2.2 (in particular, Final Consumption Expenditure — excluding superannuation).

19 The matter of electricity asset disposals and effects on the public finances is discussed in Part 4 of ‘Electricity Businesses Disposal Process in South Australia: Report by the Auditor-General Pursuant to section 22(2) of the *Electricity Corporations (Restructuring and Disposal) Act 1999* on Relevant Long Term Leases’ 27 March 2001.

These figures also include certain 'internal' payments, such as payments to public trading enterprises in reimbursement of expenditure on separation packages, a reimbursement to the South Australian Housing Trust for its tax equivalent payment and payments to the South Australian Water Corporation for community service obligations.

Certain of these payments are at their highest in the estimated result figures for 2000-01 decreasing thereafter to the end of the forward estimate period, 2004-05

CAPITAL OUTLAYS

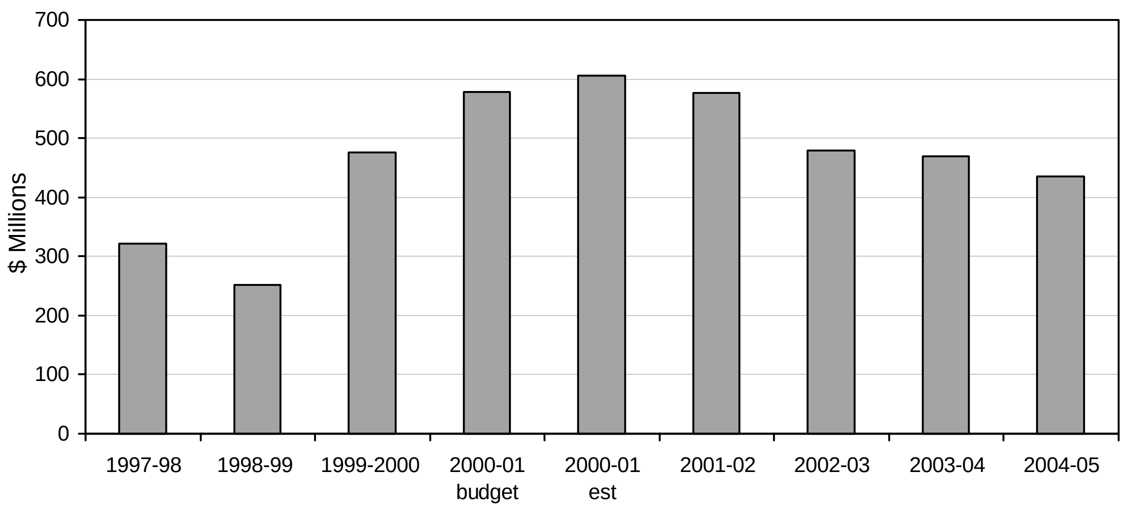
The principal tables at the beginning of this section show that capital outlays consist of three main components; gross fixed capital expenditure; capital grants; net advances.

Net advances have varied over the period. This reflects transactions, in particular loans and repayments of loans, between the non-commercial sector on the one hand and, on the other, the private sector, the State commercial sector, the State financial institutions sector and the local government sector. The large negative amount in 1997-98 reflect repayments by SAFA. The SAFA repayment was classified as an abnormal item in that year.

Audit considers that in analysing trends in non-commercial sector outlays it is useful to exclude these transactions.[20]

The following chart shows the trend of capital outlays, net of advances, over the period of the table.

Capital Outlays Net of Advances (Real)



20 Net advance transactions are different from other outlays in that they represent 'switches' in the level and location of financial assets and liabilities within the public sector as distinct from expenditure on goods or services or transfers out of the public sector. The Department of Treasury and Finance already excludes the effects of sales of businesses in the Budget presentation.

It will be seen that the:

- 2000-01 Budget provided for a large increase in capital outlays and, in the event, the estimated result is for expenditure to be above the Budget estimate due to better than predicted progress with capital works generally. In the three years to 1999-2000 actual outlays have been well below the budgeted amounts. Actual capital outlays for 2000-01 was yet to be finalised at the time of this Report;

- 2001-02 Budget provides for a decrease (nearly 4.8 percent in real terms) for 2001-02 compared to the estimated result for 2000-01 with further reductions annually through to 2004-05. The Budget papers indicate that this 'largely reflects the return to a more stable level of investment spending'.[21]

The 2001-02 Budget also indicates an intention to investigate the possibility of using public-private partnerships (Partnerships SA) for the provision of some capital projects. One of the aims of this initiative is to reduce the calls on the budget for capital investment. Any projects successfully implemented under Partnerships SA will increase the size of the capital works program. To the extent that new services are provided to the Government by the private sector, a cost will be reflected in current outlays.

REVENUES AND GRANTS

From 2000-01 there have been very significant changes to the composition of the revenue side of the Budget. Foremost in the changes are the effects of the national tax reform and revised Commonwealth-State funding arrangements.[22] Under these arrangements some State taxes have been abolished or reduced and replaced by Commonwealth funding in the form of GST revenue grants and transitional grants.

Another significant change relates to the effects of the disposal of electricity businesses which were completed in 2000-01. This has the effect of reducing revenue from commercial public trading entities.

Finally the forward estimates indicate considerable fluctuations in other State own source revenues as a result of periodic, lumpy distributions to the Budget from public financial institutions, namely SAAMC and SAFA. As discussed previously, these distributions are traditionally only called upon where required for the Government to meet the target Budget result.

The following table shows the trend projected for revenue and general purpose grants over the period 1997-98 to 2004-05.

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21 Budget Statement 2001-02, Budget Paper 3, p. 2.2.

22 Details of these arrangements are set out in the 'Budget Statement 2001-02' Budget Paper 3, section 6.5.

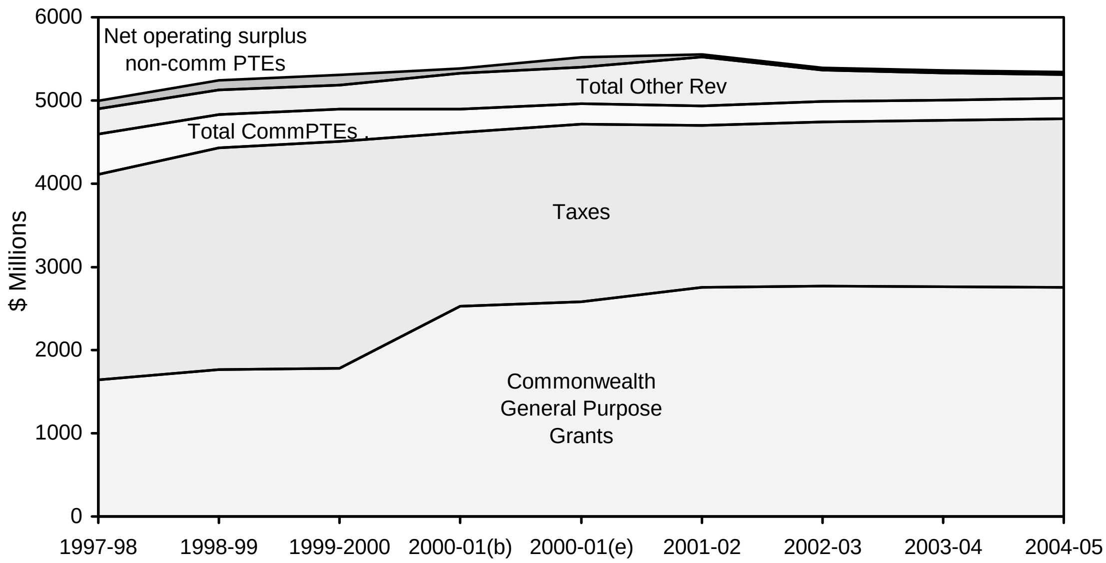
Revenue and General Purpose Grants

	Total Revenue and Grants (a) $'million	(b) Real Terms $'million	Increase Real Terms Percent	Increase Real Terms $'million	Cumulative Increase Real Terms $'million
1997-98	4 694	5 046	-	-	-
1998-99	4 926	5 244	3.9	198	198
1999-2000	5 144	5 305	1.2	60	259
2000-01 Budget	5 384	5 384	1.5	79	338
2000-01 Estimated Result	5 518	5 518	4.0	213	472
2001-02 (c)	5 677	5 554	0.6	36	507
2002-03 (c)	5 655	5 391	-2.9	-163	345
2003-04 (c)	5 767	5 365	-0.5	-26	318
2004-05 (c)	5 881	5 342	-0.4	-23	295

(a) General purpose grants only ie excludes Commonwealth Specific Purpose Payments (SPPs).
(b) 2000-01 dollars.
(c) Projections in 2001-02 Budget.

The following chart shows the significant compositional changes in revenues over the forward estimate period.

Components of Total Revenues Excluding Commonwealth SPPs (Real) (a) (b)



(a) SPP — specific purpose payments.
(b) Adjusted for abnormal items — stamp duty on electricity disposal in 1999-2000 and 2000-01 estimated result.

A number of key facts are evident from the table and the chart. They are:

- total revenue and grants are estimated to exceed budget for 2000-01;
- the trend for total revenues follows that of total outlays with a real terms decrease in total revenues from 2001-02 to the end of the forward estimate period in 2004-05;

- the magnitude of the changes outlined above, in particular from national tax reform. The rapid increase in Commonwealth general-purpose grants and the offsetting reduction in State taxation revenue in 2000-01 and 2001-02 are readily apparent;
- the steady trend of Commonwealth general purpose grants after 2001-02 and the slight increase in real terms of taxation revenues from that year;
- the increase in relative importance of Commonwealth funding to the State;
- the decrease in revenues from commercial public trading enterprises due to the disposal of electricity businesses;
- the lumpy contributions from SAAMC and SAFA in other revenues.

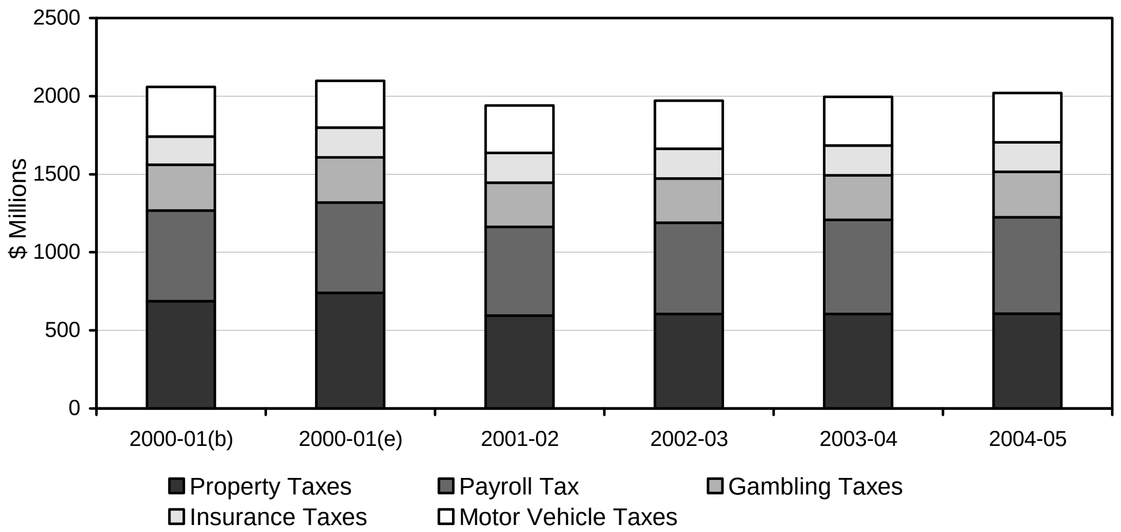
The following commentary provides some additional analysis of these overall trends and other matters.

Taxes

Total taxation receipts for 2000-01 are estimated to be $2.1 billion (excluding abnormal item) a real decrease of $592 million or 28.3 percent from 1999-2000. Because of the change in Commonwealth funding arrangements the following chart commences from the 2000-01 Budget to examine the trend in the components of taxation receipts and the trend over the period of the forward estimates.

Data has not been adjusted for comparability except for the exclusion of an abnormal item in the 2000-01 estimated result.

Taxation Components (Real)



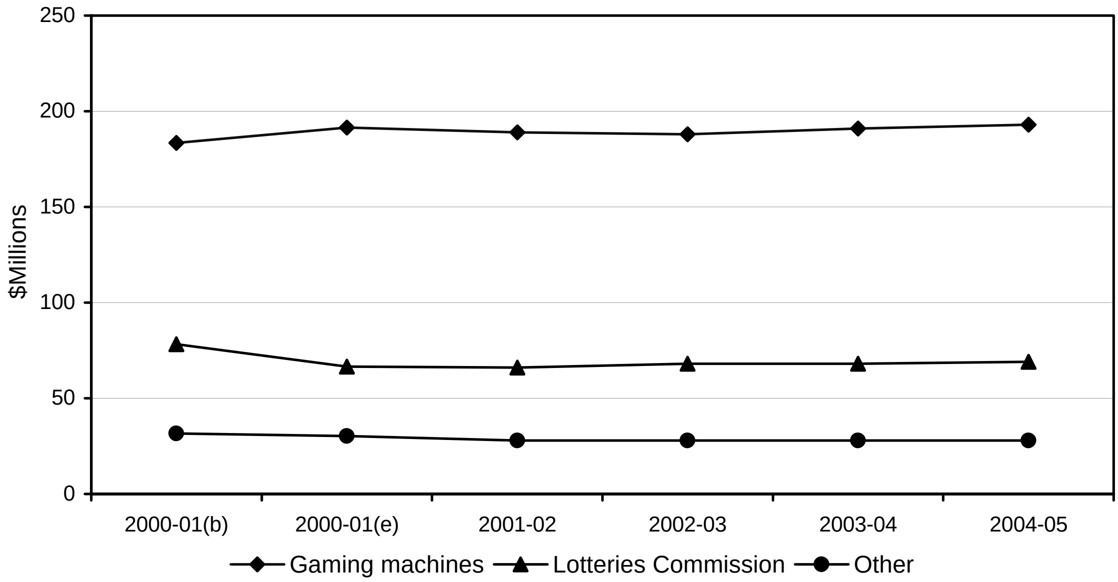
Taxation receipts are estimated to exceed budget for 2000-01. The fall in taxation in 2001-02 is due primarily to the abolition of Financial Institutions Duty and stamp duty on quoted marketable securities from 1 July 2001 as part of national tax reform changes and a reduction in the payroll tax rate, also from 1 July 2001. The slight growth in total taxation receipts after 2001-02 is apparent and is from payroll and motor vehicle taxes.

Gambling Taxes

As reported for a number of years, a very large influence on taxation income has been the introduction of gaming machines into licensed hotels and clubs.

The following chart shows the main components of gambling taxes and highlights the significance of gaming machine taxes.

Gambling Tax Components (real)



Taxation from gaming machines is estimated at $191.5 million[23] in 2000-01 exceeding budget by $8.1 million. It is budgeted to grow marginally in 2001-02 to $192.7 million. In real terms, gaming machine taxes has the largest growth over the forward estimate period of the three charted components.

Summary of Taxation Revenue Changes

The foregoing is summarised in the following table which adjusts for the effects of national tax reforms to enable a comparison over the period back to 1997-98.

The table highlights the change in taxation revenues from changes in taxation legislation and removes other adjustments from classification and internal changes together with abnormal items. The remaining amount after all adjustments is the residual tax amount. The table highlights the natural growth estimated to occur in residual taxation over the period under review. The low growth evident in 2001-02 from 2000-01 is due to a very large private sector property conveyance in 2000-01 for which there is no budgeted comparable amount in 2001-02.

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23 Budget Statement 2001-02, Budget Paper 3, Table 5.8.

Taxation Revenue

		Actual 1997-98 $'million	Actual 1998-99 $'million	Actual 1999-00 $'million	Estimated Outcome 2000-01 $'million	Estimate 2001-02 $'million	Estimate 2002-03 $'million	Estimate 2003-04 $'million	Estimate 2004-05 $'million
1.	Total	2 296.4	2 504.4	2 745.5	2 172.2	1 983.7	2 067.9	2 146.3	2 226.7
2.	Amount attributable to national tax reform changes	-	-	-	-594.3	-753.4	-788.2	-815.8	-844.3
3.	Amount attributable to other changes in taxation legislation (a)	-6.0	89.2	141.1	132.0	96.6	94.7	93.6	94.1
4.	Total amount attributable to legislative changes (b)	-6.0	89.2	141.1	-462.3	-656.8	-693.5	-722.2	-750.2
5.	Classification change	-	-	-24.3	-40.9	-44.5	-51.7	-42.9	-40.6
6.	'Internal' changes (c)	-36.2	-48.7	-49.7	-52.3	-54.4	-56.6	-59.0	-61.4
7.	Abnormal stamp duty receipts associated with the sale of government assets	3.1	-	103.6	39.0	-	-	-	-
8.	Residual amount	2 335.5	2 463.9	2 574.8	2 688.7	2 739.4	2 869.7	2 970.5	3 078.9
	Growth Rates		5.5%	4.5%	4.4%	1.9%	4.8%	3.5%	3.7%

Note: Totals may not add due to rounding.

(a) Based on data provided by Department of Treasury and Finance. Item (4) excludes changes referred to in item (7). Includes the net budgetary impact of the emergency services levy. Note that increased tax on gaming machines in the Casino is included in item (4) as is revenue raised from Water Catchment levies.

(b) Equals total of (2) and (3).

(c) Reflects the abolition of the electricity levy which does not affect the overall non-commercial sector result.

Income from Commercial Public Trading Enterprises

In past years, by far the largest component of this item has been returns from the electricity sector as dividends and income tax equivalents. As a result of the disposal of the electricity businesses this item has now reduced markedly.

Effectively the only distributions of any consequence are obtained from SA Water Corporation which is estimated to provide $226.4 million in 2000-01 falling to $207.3 million in 2001-02 and then rising again over the remaining years to 2004-05.[24] The actual distribution for 2000-01 includes a dividend of $135.5 million, representing 96 percent of profit and also a return of capital $29.7 million. Details are provided under SA Water Corporation in Part B of this Report.

From 2001-02 ForestrySA commences making distributions to the Budget starting with $22.7 million and rising to $31.1 million in 2004-05.[25]

Other Revenue

The main source of revenue projected for this category is income from SAAMC and SAFA. From 2000-01 it is anticipated that income from mining royalties will be sustained at a level of about $100 million (from around $70 million) over the forward estimate period given higher price assumptions in particular.

Distributions from SAAMC and SAFA

Other State own-source revenues fluctuate over the forward estimates period due to the lumpy distributions projected from SAAMC and SAFA.

Distributions from these entities have in recent years been estimated to provide large amounts to the Budget but have generally not been required. This is illustrated by the 2000-01 Budget where $109 million was estimated to be received from SAAMC. This entire amount has now been deferred to 2001-02. Over the three years to and including 2000-01, the actual result has been that $38.3 million has been returned to the Budget from SAFA tax equivalent payments.

The following chart demonstrates the budgeted and actual distributions for the three years to 2000-01. The lumpiness of the SAAMC and SAFA contributions is evident.

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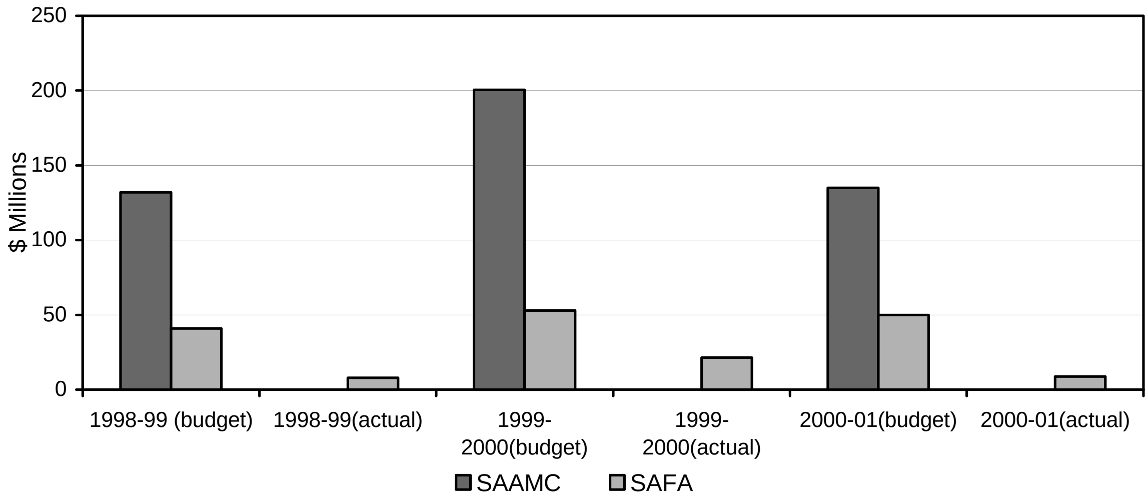
24 Budget Statement 2001-02, Budget Paper 3, Table 5.10.

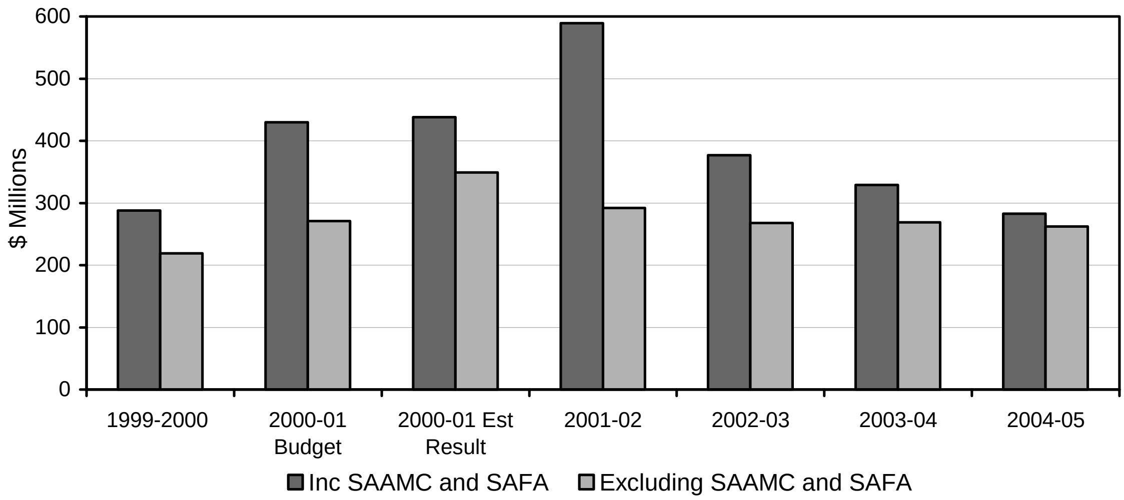
25 ibid.

Budgeted and Actual Distributions



The following chart shows other revenue including and excluding SAAMC and SAFA receipts for the period from 1997-98. Also evident is the lack of growth in the remaining components of other revenue.

Other Revenue Including and Excluding SAAMC and SAFA Receipts (Real)



Details of these contributions are shown in the Budget Papers.[26]

Accumulated Reserves for Public Financial Institutions

The following chart, based on data provided by the Department of Treasury and Finance, shows projected accumulated reserves for all of the public financial institutions over the forward estimates period.

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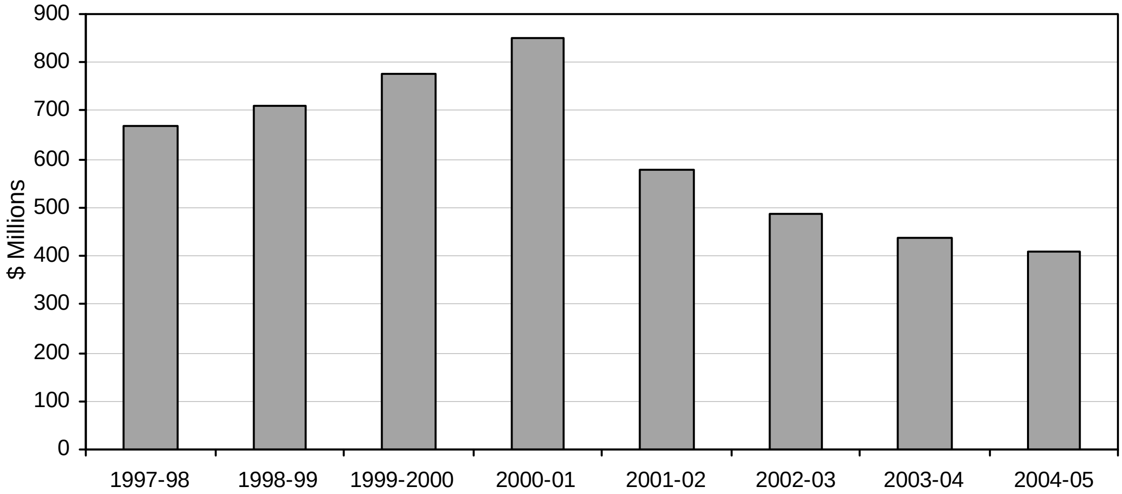
[26] Budget Statement 2001-02, Budget Paper 3, Table 5.11.

Accumulated Reserves for Public Financial Institutions



The chart indicates that accumulated reserves increased up until 2000-01, as distributions were continuously deferred and are then projected to reduce annually through to 2004-05. The distributions projected to 2004-05 have a substantial negative impact on the total accumulated reserves, projected to move from $851.5 million in 2000-01 to $407 million in 2004-05 and must be regarded as one-offs when they occur. In this regard it is not evident that these funds would be used to meet one-off or unusually high capital works. A lower capital program is forecast from 2002-03.

In regard to SAFA, a review of its capitalisation by the Department of Treasury and Finance has determined that it currently retains a higher level of capital than is required for its ongoing operation. Its retained earnings will be reduced to $75 million. This accounts for $92 million of the preceding reduction of reserves over the forward estimate period.

The circumstances for SAFA emphasises the fact that these entities will not collectively be able to replace the quantum of funds anticipated being withdrawn over the forward estimate period.

Commonwealth General Purpose Grants

As already mentioned, Commonwealth general purpose grants increased significantly in 2000-01, as a result of national tax reform arrangements. Receipts for 2000-01 are estimated to exceed Budget by $55 million and amount to $2.6 billion. They are budgeted to increase to $2.8 billion in 2001-02 and then remain steady in real terms through to 2004-05.

The Budget Papers indicate that South Australia is estimated to gain from tax reform from 2006-07 and that benefits will derive from the fact that the Goods and Services Tax (GST) is a genuine growth tax.[27]

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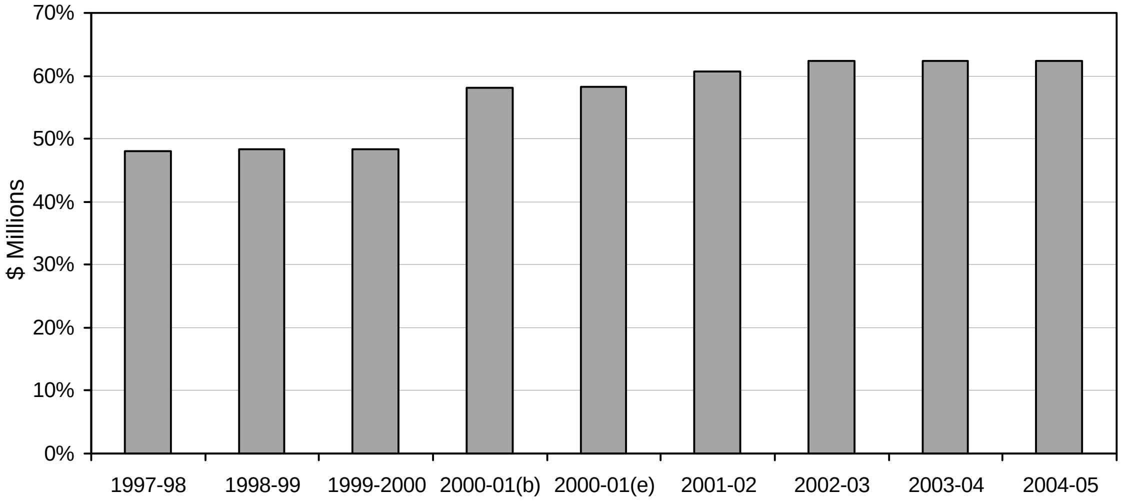
[27] Budget Statement 2001-02, Budget Paper 3, p. 6.18 and Table 6.3.

The impact of national tax reform in respect to the State's dependence on the Commonwealth for revenue is demonstrated in the following chart.

Proportion of Commonwealth General Purpose Grants to Total Revenue (excluding SPPs)



Over the period the proportion of Commonwealth general-purpose grants to total revenue, excluding SPPs, increases from 48.1 percent to 62.4 percent. The reliance of the State on Commonwealth funding is apparent. If, however, GST funding is regarded as State revenues, the Commonwealth proportion is about 23 percent of revenues as at 2004-05.

THE ACCRUAL BUDGET

INTRODUCTION

The Government has used the cash based non-commercial sector operating result as its focus for financial management strategy (the Budget refers to these as fiscal strategy) since the Commission of Audit in 1994.

Since 1994 there have been a number of additional or supplementary accrual based targets introduced. Apart from net debt and unfunded superannuation targets, these have always been subordinate to the cash based focus in Budgets and have generally been discontinued in subsequent Budget Papers as public sector financial reporting has developed and focus has changed.

In my last Report I noted that, in my opinion, it would be timely for the matter of appropriate fiscal targets for the State to be addressed in the near future. This would assist to enable planning for the implementation of the necessary support mechanisms for such targets and for targets to be built into management practices as appropriate.

Circumstances are now such that I believe it is imperative for the Government to set out the detail of a revised long-term basis for fiscal strategy and related monitoring and reporting.

While such issues are hardly likely to be at the forefront of the general community's concerns, this is a fundamental matter for public financial administration.

Cash based systems have a powerful attraction in their simplicity, however, virtually all forms of public sector financial reporting have moved to accrual based systems. This aligns with the view that improved information is available to the user to support decision making.

This section provides information on the current position for accrual based budgets.

DEVELOPMENTS IN PUBLIC SECTOR FINANCIAL REPORTING

In 1997-98 all Government agencies adopted accrual accounting and financial reporting in accordance with Accounting Standard AAS 29 'Financial Reporting by Government Departments'.

In 1998-99 the Budget Papers introduced an analysis of the Budget from an accrual budget perspective for the first time. This included traditional financial reporting of an operating statement and statement of financial position for the non-commercial sector.

In 1998-99 Accounting Standard AAS 31 'Financial Reporting by Governments' became operative. Whole-of-government reporting has been prepared in this State since that time.[28]

In 1999-2000 the Australian Bureau of Statistics (ABS) adopted accrual based Government Financial Statistics (GFS) for public sector financial statistics reporting, having previously used a cash based methodology. All of the States adopted this for uniform reporting, which is supplementary information reported in budgets and budget result documents by each jurisdiction. In this State, the Budget Results for 1999-2000 included a presentation in accordance with the new accrual GFS method.

CASH VERSUS ACCRUAL

The advantages and disadvantages of cash and accrual systems have been debated before 1997-98 when accrual accounting was introduced. Without going over those arguments it is relevant to make a number of observations from more recent experience.

I have indicated elsewhere in this Report that one matter in relation to the cash based system is the way in which the budgeted result can be, and is, achieved through final central adjustments. This process means the actual result does not necessarily relate to the budgeted flows for a year but rather the actual flows as adjusted to achieve the budgeted result.

While accrual reporting does not eliminate the opportunity for such adjustments, the process is less likely to occur. This would particularly be so if the focus shifted to an explanation of variations and performance over a cycle (rather than one year) to allow for unplanned impacts such as changes of intergovernmental arrangements.

The key argument in the past for accrual accounting was that the cash basis does not capture all financial implications of a years' activity. In my view, experience to date is that accrual reporting better captures the impact of all transactions (including accruing liabilities and revenues). Subsets of information can be derived from that base for specific purposes.

THE BUDGET PAPERS

The Budget Papers have included a section on accrual budget data since the 1998-99 Budget. This was based on Accounting Standards (AASs).

In the 2001-02 Budget Papers the following position arises:

- the financial (fiscal) target is GFS cash based;
- portfolio statements supporting the Budget are AAS accrual based;
- uniform reporting (agreed reporting by all jurisdictions) is GFS accrual based.

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28 Refer to the section in this Part 'Whole-of-Government Financial Statements'.

Such a range of reporting must be regarded as administratively costly and risks being confusing not only for readers but more importantly for preparers and managers who may find conflicting imperatives arising from the different reporting regimes that affect the quality and usefulness of information and decision making.

In this environment the Department of Treasury and Finance have undertaken a review of future financial (the Budget refers to these as fiscal) targets during 2000-01 following from an earlier review in April 2000. The outcome of the review has not yet resulted in a change to the primary basis for Budget presentation and the specific target/s.

It is, however, indicative that the accrual budget section of the 2001-02 Budget Papers now reports information prepared in accordance with the ABS GFS accrual basis of reporting.

The AAS basis remains the basis for agency (budget and actual) and whole-of-government (actuals only) reporting.

I believe it is important that the fiscal targets for the future be determined and implemented for the next Budget.

DEVELOPING A FISCAL TARGET

The importance of fiscal targets is that they establish the focus and framework for financial activity, control and accountability. In the private sector they would include profit and return on shareholders funds. In the public sector such measures have little relevance. The matters to be considered in establishing fiscal measures and targets for a State Government's wide ranging activities include the following:

- scope of government activity for focus;
- method of recording and reporting;
- fiscal measures;
- specific fiscal targets.

It is also important that measures be understandable and easy to produce, monitor and report. The following discusses some considerations in relation to these matters.

Scope

I have mentioned that State Government activities cover a wide range of activities. The ABS identifies three sectors of government activity, which, in my opinion, while not named for ease of use, reflect the main and separable segments.[29] They are:

General Government — all Budget dependent departments and agencies.

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29 Appendix D to 'Budget Statement 2001-02' Budget Paper 3 sets out each of the entities in the South Australian public sector and their ABS classification.

Public Non-financial Corporations (PNFCs) — trading enterprises most of which will receive budget subsidies for at least some part of their operations. In South Australian the sector includes SA Housing Trust, SA Water Corporation and TransAdelaide.

Public Financial Corporations — financial institutions such as the South Australian Government Financing Authority (SAFA) and South Australian Asset Management Corporation (SAAMC).

The non-commercial sector currently used derived from the Commission of Audit and is peculiar to South Australia. It overlaps but does not envelop the general government and public non-financial corporations sectors. A choice of one or more of the preceding would bring the State into line with an accepted practice.

Method of Recording and Reporting

I have already outlined that the two methods of recording and reporting are the AAS and GFS bases. The GFS basis is clearly favoured by the State Treasuries as it has been adopted for uniform reporting as agreed by the States. It is considered a robust methodology that allows comparison between jurisdictions. AAS is, as mentioned, used by individual agencies and in whole-of-government reporting and the business community. It is therefore well known.

Again, for State Government financial reporting, aspects of AAS reporting are not as relevant as they are for the private sector. The GFS method is therefore understandably the more favoured methodology, particularly for Budget strategy.

Fiscal Measures

Under AAS the focus of reporting includes financial operating performance and movements in net assets (which incudes revaluations and equity distributions).

Under GFS there is a range of fiscal measures but two are predominate, namely, the:

- ***net operating balance*** — the difference between GFS revenue and GFS expenses. The net operating balance includes non-cash expenses such as accruing employee entitlements and depreciation.

- ***net lending/borrowing*** (sometimes referred to as fiscal balance) — A government's net lending/borrowing is calculated by deducting the net acquisition of non-financial assets (equivalent to net capital expenditure less depreciation expense)[30] from the net operating balance. By including the full amount of investment spending, the extent to which total spending decisions, including social capital spending, are covered by current revenues is shown. Where current revenues do not cover total spending, borrowing is required.

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[30] The assumption is that depreciation expense is recovered in operating revenues.

Specific Fiscal Targets

Specific fiscal targets include surpluses, balanced budgets and average outcomes. They must suit the circumstances of the reporting jurisdiction.

It might be expected that in the normal course, a jurisdiction would target achieving surpluses from its financial operations. This reflects ability to live within means and to build up reserves for leaner periods.

In South Australia, the focus has been on balanced budgets. Initially this was to eliminate deficits and once that was achieved, to spend up to the available resources in providing public services.

Average outcomes would be in place where there is an expectation of surpluses and deficit over an economic cycle. Consideration of performance over an economic cycle takes away the focus that, for example, short term deficits might cause for a government.

Australian States

In considering the preceding matters, it is useful to note what is current practice across Australian jurisdictions. The following table summarises the current position for some States including South Australia.

State	Fiscal Measure	Scope	Method of Recording and Reporting	Fiscal Target
NSW	Fiscal balance	General government	GFS accrual	Surplus
Victoria	Operating result	Budget - (adjusted General government)	AAS	Surplus no less than $100 million per annum
Queensland	Operating result	General government	GFS accrual	Surplus
WA	Operating result	General government	GFS accrual	Surplus
SA	Underlying cash result	Non-commercial sector	GFS cash	Balance

Source — Department of Treasury and Finance

While it is evident that there is some variation between the States, the most prevalent position is to target surpluses in the general government sector, based on the GFS accrual method.

I have mentioned that the 2001-02 Budget Papers now report information prepared in accordance with the ABS GFS accrual basis of reporting. This is in accordance with an agreement between the Commonwealth and the States to provide common information for comparison between each government. That information includes a focus on both the operating result and fiscal balance for the general government sector.

Changing from the Non-Commercial Sector

The non-commercial sector includes virtually all agencies except commercial (profit oriented) agencies of which SA Water Corporation is the largest.

The 2001-02 Budget Papers state:

> *Given that the impact on the financial position of the Government from the non-commercial PNFCs is reflected in payments from the general government sector to those PNFCs the general government figures represent the Government's overall budgetary position.*[31]

To focus on a smaller sector such as the general government sector introduces some issues. One of particular importance, in my opinion, is the following.

Forward Estimates

General government is a smaller part of the public sector than the non-commercial sector as it does not include non-commercial PNFCs. While transactions with the other sectors will be included in the general government sector results, I believe it important that relevant information also be available for the PNFC sector in particular. Currently the non-commercial sector picks up four year forward estimates for the non-commercial sector. By comparison, the PNFC published data is only for the immediate budget year. I believe it important that comparative period information be available for users so as not to lose sight of the broader public sector activity.

The preparation of such information provides a basis for retaining disciplines that have been sought over a number of years to control outlays and borrowings in particular. This approach is suggested as a minimum requirement for reporting on the PNFC sector. I note that the Department of Treasury and Finance is considering a number of additional and specific initiatives that would ensure a strong control framework. I support the intentions of such a framework.

The 2001-02 Budget

Overall, I believe the reporting initiatives in the 2001-02 Budget Papers to be sound and consistent with general practice being adopted in all Australian jurisdictions.

THE 2001-02 ACCRUAL BUDGET

Operating Statement

The 2001-02 Budget provides detailed information in accordance with uniform reporting arrangements. The following summarises the operating result and fiscal balance data for the general government sector.

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31 'Budget Statement 2001-02' Budget Paper 3, p. 3.1.

General Government Operating Result and Fiscal Balance Data

	Actual 1999-2000 $'million	Budget 2000-01 $'million	Estimated Result 2000-01 $'million	Estimate 2001-02 $'million	Estimate 2002-03 $'million	Estimate 2003-04 $'million	Estimate 2004-05 $'million
GFS Revenue	7 644	7 999	7 880	8 141	8 194	8 319	8 470
GFS Expenses	7 974	8 191	8 101	8 179	8 174	8 314	8 387
Net Operating Balance	-330	-192	-221	-38	19	4	83
Less: Total net acquisition of non-financial assets	140	150	125	171	130	135	144
Fiscal Balance (Net Borrowing)	-471	-342	-346	-209	-111	-130	-61

The data indicates anticipated improvements in both the operating result and fiscal balance data in 2001-02 and then less change over the remaining period of the forward estimates. Similar to the analysis in the previous section of this Report, the improvements in 2001-02 derive from improvements in revenues in 2001-02.

The indicator Fiscal Balance (Net Borrowing) was first reported in the 1998-99 Budget as a supplementary target and relates to financing capital outlays from recurrent surpluses. The target was for the non-commercial sector. The 2001-02 Budget indicates that this is not currently a specific target. It does state that achieving a balance in net lending will be a budget objective by the end of the next four-year financial plan.

As indicated in the table, this aim is not expected to be met through the forward estimate period for the general government sector as other priorities prevail for the available revenues.

Comparison with Other States

I have noted that the cash based non-commercial sector is peculiar to this State.

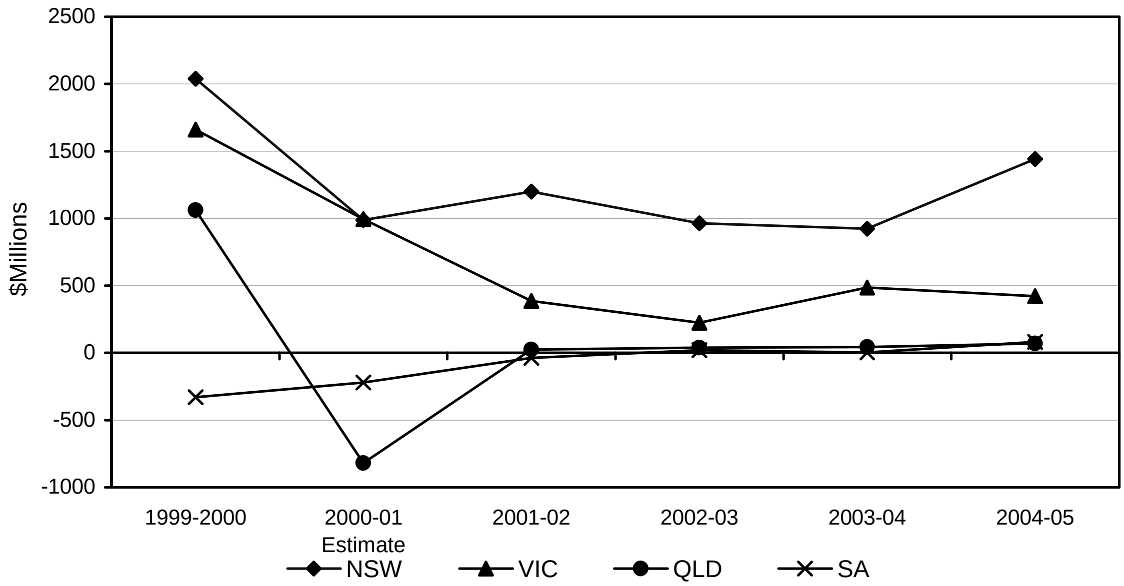
The GFS accrual information is available for all States (subject to timing) as a result of uniform reporting. With the commencement of this form of reporting it is useful to consider the results and projections across State Governments.

Importantly before drawing conclusions, any assessment needs a sound understanding of the specific circumstances prevailing in different States. I have not sought to provide all of the relevant information in this Report. Rather I take the opportunity to give a flavour of what might be expected to occur in the future.

Net Operating Balance

The following chart compares some trends in the GFS accrual information with some other States.

General Government Net Operating Balance (Nominal)



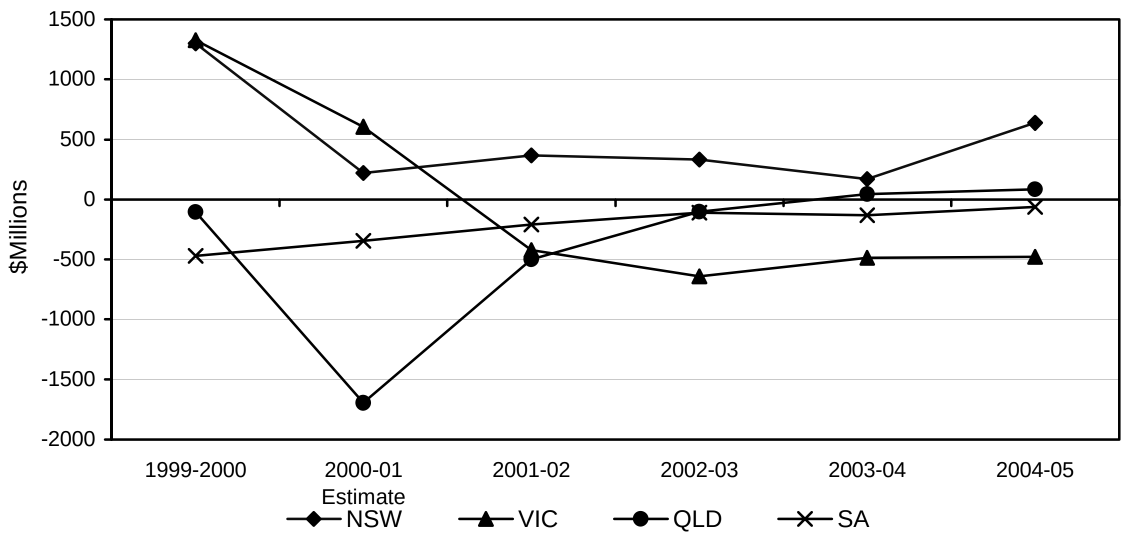
The chart shows that South Australia and Queensland are reporting similar outcomes over the forward estimate period, while NSW and Victoria are projecting surpluses.

The circumstances of South Australia and Queensland are, however, very different. Queensland's results come on the back of revenues growing 16 percent (nominally) over the forward estimate period compared to South Australia's 7.5 percent. The balanced results are achieved in an environment of stronger growth in revenues and outlays.

Fiscal Balance

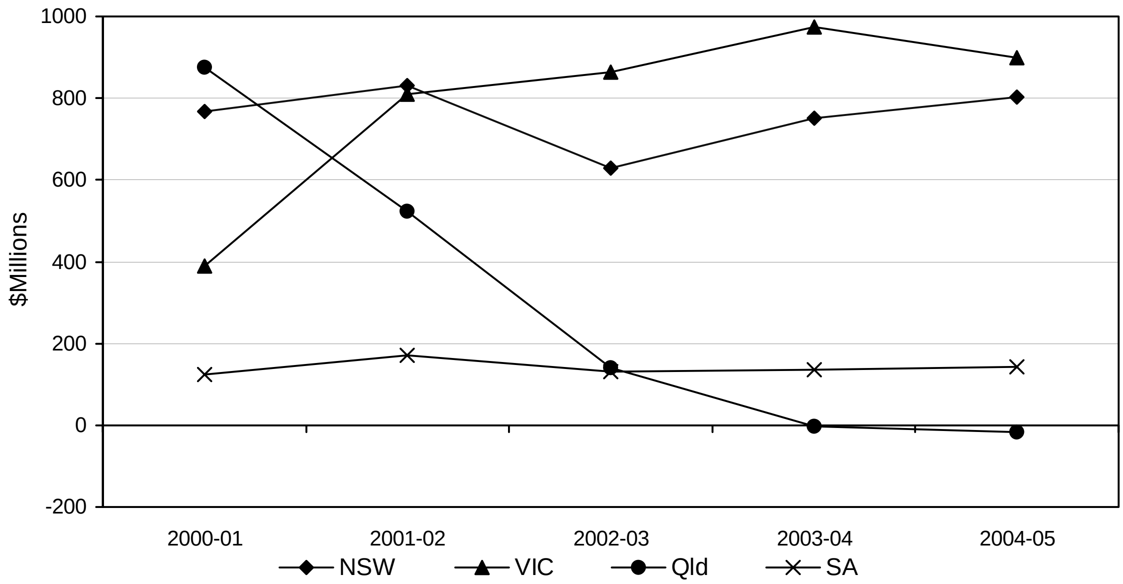
As mentioned, the fiscal balance represents whether a government has funded capital expenditure, net of deprecation expense, from a surplus net operating balance. The following chart compares some trends with some other States.

General Government Fiscal Balance (Nominal)



As detailed in the table, South Australia is projecting consistent improvements in this indicator. Only NSW consistently has a surplus fiscal balance. The other States are borrowing for all or most of the period reviewed. The following chart gives some perspective to this result.

General Government Net Acquisition of Non-financial Assets (Nominal)



South Australia's net acquisitions of non-financial assets is stable over the forward period after reducing in 2002-03. Victoria is projecting growth for most of the period while Queensland is coming off a peak in 2000-01 and declining right across the period.

Balance Sheet

The following summarises the GFS balance sheet information for South Australia.

General Government GFS Balance Sheet Data (Nominal Terms)

	Actual 1999-2000 $'million	Estimated Result 2000-01 $'million	Budget 2001-02 $'million	Estimate 2002-03 $'million	Estimate 2003-04 $'million	Estimate 2004-05 $'million
Assets	24 529	23 041	23 210	23 562	23 956	24 406
Liabilities	12 082	9 718	9 837	10 097	10 404	10 693
Net Worth	12 447	13 323	13 373	13 465	13 553	13 714
Net Financial Worth	2 986	3 832	3 661	3 594	3 549	3 613

An analysis of balance sheet information is provided in two sections of this Report. 'State Debt and Other Liabilities' considers GFS data. The section 'Whole-of-Government Financial Statements' considers AAS based data.

Summary Observations

The preceding data is provided to give a context to what is very new financial information. It is indicative only, as it is necessary to analyse the circumstances prevailing in individual jurisdictions to give some substance to the trends that appear.

CONCLUSIONS

Fiscal Targets

In my last Report I noted that in my opinion, it would be timely for the matter of appropriate fiscal targets for the State to be addressed in the near future.

Circumstances are now such that I believe it is imperative for the Government to set out the detail of a revised long-term basis for fiscal strategy and related monitoring and reporting.

I believe it is important that the fiscal targets for the future be determined and implemented for the next Budget.

Overall, I believe the reporting initiatives in the 2001-02 Budget Papers to be sound and consistent with general practice being adopted in all Australian jurisdictions.

2001-02 Budget Data

The data indicates anticipated improvements in both the operating result and fiscal balance data in 2001-02 due to improvements in revenues. There is less change over the remaining period of the forward estimates.

The indicator Fiscal Balance (Net Lending) relating to financing capital outlays from recurrent surpluses is not expected to be met through the forward estimate period for the general government sector. This is not, however, a target until the completion of the next four year financial plan.

STATE DEBT AND OTHER LIABILITIES

INTRODUCTION

Until 2000-01 the major element of the State's liabilities was net debt. The other major liability is unfunded superannuation liabilities that have accrued over many years.

Following the use of proceeds from the disposal of the State's electricity assets for debt retirement, at 30 June 2001 net debt is estimated to be $3 270 million. This is now lower than the balance of unfunded superannuation liabilities, which is estimated to be $3 301 million.

Net debt is projected to steadily decrease in real terms over the period of the 2001-02 Budget to 2004-05 although in nominal terms it grows in the next two years. Unfunded superannuation liabilities are also estimated to steadily decrease in real terms over that period although in nominal terms they will grow until peaking about 2013. The Government's program for fully funding superannuation liabilities continues.

This section of the Report tracks trends in net debt, unfunded superannuation liabilities and other liabilities of the State. Included are a range of debt measures and indicators that assist in monitoring the position in relation to debt management in past and future years and commentary on factors that have influenced, or are influencing the State's liabilities.

BACKGROUND

In the 1998-99 Budget, the Government set out a four-year financial plan. Two key elements of the strategy outlined in that plan were continuing real reduction in net debt and the elimination of unfunded superannuation liabilities by 2024. A major asset sales program announced in February 1998 was the basis of achieving a significant real rate of debt reduction.[32]

In the 1999-2000 Budget tabled in May 1999, the target with respect to fully funding superannuation liabilities was extended to 2034 in line with that of New South Wales (NSW) and Victoria.[33] This change allowed an outlay saving in the order of $55 million per annum.

In June 1999 Parliament passed legislation enabling the lease or sale of publicly owned electricity assets, the largest public sector asset disposal in the State's history. The legislation required the net proceeds from the disposal to be used for debt retirement.

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[32] Budget Statement 1998-99, Budget Paper 2, p. 1-1.

[33] NSW plans to fully fund its public sector superannuation liabilities by 2030 and Victoria by 2035.

Definition of Net Debt

The net debt figures referred to in the Budget papers and this Report are based on Australian Bureau of Statistics (ABS) Government Finance Statistics (GFS) definitions.[34] Further, the figure in focus relates to the net debt of what is referred to as the non-financial public sector that is comprised of all public sector entities except for public financial corporations such as the South Australian Government Financing Authority (SAFA).[35]

Book Values and Market Values

Debt data is now reported at both book value (reflecting the initial yield of individual transactions), and market value or replacement cost in the financial statements of entities and the whole-of-government accounts. Differences between the two arise when fixed rate debt has been raised at interest rates different from current rates.[36]

Data has not been published recently for the non-financial public sector.[37] Data previously available (as at 30 June 1999) indicated a large gap between book and market values. That gap was reducing and it can be expected that this trend has continued given the retirement of debt and the fact that high yield debt has matured or been repurchased over the period so that average yields of remaining debt are closer to market values. The reduction in the gap also arises from the realisation of accounting losses as discussed later in this section.

Debt as Part of the Government's Overall Balance Sheet

It is fundamental that debt is only one part of a government's balance sheet and that a full assessment of the State's financial position should take account of physical public assets and commercial assets as well as financial liabilities and assets. There are other measures included in this section that are broader than net debt. The section in this Part titled 'Whole of Government Financial Statements' presents full financial statement information.

Debt reductions achieved by the State in recent years would, all other things being equal, coincide with overall balance sheet reduction as they result from major asset disposals. A further aim of the Government with regard to commercial asset disposals was to reduce the Government's exposure to a range of operational, financial (including interest rate) and

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34 See Appendix A to 'Budget Statement 2001-02', Budget Paper 3. For example, net debt is calculated as the sum of deposits held, advances received and borrowing, minus the sum of cash and deposits, advances paid and investments, loans and placements. This can present differently to information presented in line with Accounting Standards.

35 There are nine entities in this ABS sector including HomeStart Finance and the South Australian Asset Management Corporation. Full details are set out in Appendix D to 'Budget Statement 2001-02' Budget Paper 3.

36 Take the example of borrowing $1 million for a two-year term at an interest rate of 10 percent, ie an interest cost of $100 000 per year. Should interest rates immediately decrease to say 8 percent, the borrower would have to pay more than $1 million to repurchase the debt because a lender would want to maintain the yield (interest rate) of 10 percent or $100 000 per year originally available. At a rate of 8 percent the lender will need to reinvest more than $1 million to earn $100 000 per year. As a result, as interest rates fall the market value of the debt increases and the opposite is true for interest rate increases.

37 Whole-of-government data is published in the annual whole-of-government financial statements.

economic risks that had the capacity, if they could not be appropriately managed, to impact on future finances. These can be regarded as structural improvements in the State's financial position to the extent that risk is avoided.

DEBT AND OTHER LIABILITY MEASURES AND TRENDS

Debt and Other Liability Measures and Indicators

There are a variety of measures and indicators in relation to debt burden that are generally accepted. The measures and indicators included in this section of the Report encompass:

- net debt and unfunded superannuation liabilities — nominal and real terms;
- a reconciliation of net debt and deficits;
- ratios relating to debt affordability and debt servicing;
- net worth, net financial worth, non-financial assets and the State's position relative to some other States.

Longer Term Trends in the Level of Debt

The following tables show data on a long-term basis. In 1997-98 some changes to ABS classifications to exclude universities and SAFA from the non-financial public sector have created a break in the time series data available. The effect was to increase the net debt figure for the non-financial public sector because of the exclusion of factors such as SAFA's capital and the cash assets of universities from the calculation.

South Australian Public Sector Net Indebtedness 1950 to 1998

June	Nominal Prices $'million	Real Terms (a) $'million	Per Capita (Real Terms) $	Percentage of GSP Percent
1950	284	n/a	n/a	n/a
1960	752	n/a	n/a	n/a
1970	1 473	11 113	9 596	n/a
1980	2 242	6 393	4 886	n/a
1990	4 682	6 077	4 243	16.3
1991	7 155	8 746	6 047	24.4
1992	8 055	9 597	6 589	26.9
1993	8 249	9 630	6 593	26.9
1994	8 440	9 708	6 622	26.2
1995	8 468	9 380	6 383	25.4
1996	7 752	8 362	5 672	21.6
1997	7 499	8 095	5 471	20.6
1998	7 237	7 780	5 231	18.6

South Australian Public Sector Net Indebtedness 1997 to 2005 (New Series)

	Nominal Prices $'million	Real Terms (a) $'million	Per Capita (Real Terms) $	Percentage of GSP Percent
New Series				
1997	7 946	8 577	5 797	21.8
1998	7 589	8 158	5 489	19.3
1999	7 720	8 219	5 507	19.3
2000	4 355	4 491	2 997	10.3
2001 (b)	3 270	3 270	2 176	7.2
2002 (c)	3 392	3 318	2 201	7.2
2003 (c)	3 451	3 290	2 176	7.0
2004 (c)	3 433	3 193	2 106	6.6
2005 (c)	3 356	3 048	2 004	6.1

(a) Estimated June 2001 values
(b) Estimated result
(c) Projections

It will be seen that net debt reduced in real terms from the 1970s until 1990 but then rose substantially as a result of the need to fund the losses of the State Bank of South Australia in particular, reaching a peak in real terms in 1994.

Retirement of Debt with the Net Proceeds of Electricity Asset Disposals

The major reduction in 2000 and 2001 resulted from the retirement of debt with the net proceeds of electricity asset disposals. The total proceeds available for debt reduction amounted to $4.9 billion. Over the period 1999-2000 to 2000-01 net debt reduced from $7.7 billion to $3.3 billion a reduction of $4.4 billion. As discussed in my previous Report[38] and in the Budget Papers,[39] a large part of the difference of $0.5 billion was due to the realisation of previously unrealised book losses of about $200 million as a result of debt management activities mainly related to the repayment of debt following the receipt of the electricity privatisation proceeds. The losses are offset by lower future interest payments.

Further, as discussed later in this section under the heading 'Net Debt and Deficits', deficits on operations in the non-commercial and commercial sectors are estimated to add $235 million to debt over the two-year period 1999-2000 to 2000-01.

Net debt is projected to rise in real terms in 2002 but reduce in real terms from then to 2005.

Composition of Net Debt

Gross Debt and Financial Assets

The following table shows how the composition of net debt was expected to change over the four years to 2002 at the time of the 2001-02 Budget.

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[38] Report of the Auditor-General for the year ended 30 June 2000, Part A, p. 99.

[39] See 'Budget Statement 2001-02', Budget Paper 3, p. 7.4.

Composition of Net Debt
(Nominal Prices)

Year	Gross Debt $'million	Financial Assets (a) $'million	Net Debt $'million
1999	10 037	2 317	7 720
2000	8 043	3 688	4 355
2001 (b)	5 736	2 465	3 271
2002 (c)	5 854	2 462	3 392

(a) Comprises cash, deposits, investments and loans
(b) Estimated result
(c) Projections

As can be seen from the table gross debt has fallen markedly as a result of debt retirement from the proceeds of the electricity asset disposals over the period 1999 to 2001. The high financial assets for 2000 were due to proceeds from asset disposals being held at the end of that year pending their use for debt retirement.

General Government and Public Non-Financial Corporation Net Debt

Total net debt of the two sectors of the non-financial public sector for the four years 1999 to 2002 is set out in the following table.

General Government and Public Non-Financial Corporation Net Debt at 30 June
(Nominal Prices)

Sector	1999 $'million	2000 $'million	2001 $'million	2002 $'million
General government	4 862	1 920	1 249	1 265
Public non-financial corporations	2 869	2 440	2 022	2 127
	7 720	4 355	3 270	3 392

It can be seen that the reduction in net debt in 2000-01 was $671 million for the general government sector and $418 million for the public non-financial corporation sector (debt of the former electricity businesses disposed of in 2000-01). Most debt now resides with the public non-financial corporation sector.

The main holders of debt in that sector are SA Water Corporation, the SA Housing Trust and TransAdelaide. Of these SA Water Corporation is a commercial business servicing its debt from business revenues.

Net Debt and Unfunded Superannuation Liabilities

Account needs to be taken of unfunded superannuation liabilities as well as net debt. This is because these items are both very significant and they are, to a high degree, interchangeable — that is a choice is made to change one or the other. Under Government Financial Statistic reporting, superannuation liabilities are treated as debt with a nominal interest expense calculated annually for financial reporting.

The estimated total debt and unfunded superannuation liability as at 30 June 2001 was $6 571 million ($7 898 million in 2000) comprising debt of $3 270 million ($4 355 million) and an unfunded superannuation liability of $3 301 million ($3 543 million).

The following table provides net debt and unfunded superannuation liability for the new series data, ie from 1997.

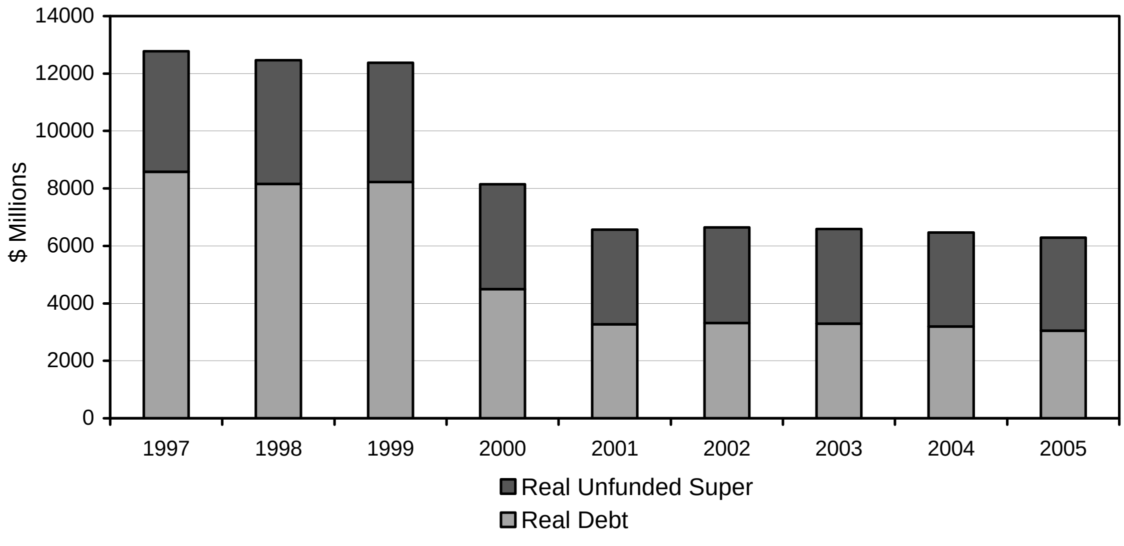
Net Debt and Unfunded Superannuation Liabilities

June	Net Debt (a) Nominal Prices $'million	Unfunded Superannuation Liabilities $'million	Total $'million	Total in Real Terms (b) $'million
1997	7 946	3 893	11 944	12 779
1998	7 589	4 001	11 590	12 460
1999	7 720	3 909	11 629	12 380
2000	4 355	3 543	7 898	8 145
2001 (c)	3 270	3 301	6 571	6 571
2002 (d)	3 392	3 399	6 791	6 644
2003 (d)	3 451	3 459	6 910	6 587
2004 (d)	3 433	3 516	6 949	6 464
2005 (d)	3 356	3 569	6 925	6 290

(a) Including the effects of the sale of government businesses
(b) June 2001 values
(c) Estimated result
(d) Projections

The following chart illustrates the consequences of the disposal of electricity assets on the trend in total net debt and unfunded superannuation liabilities in real terms over the reported period for the new series data.

Net Debt and Unfunded Superannuation Liabilities — New Series Real Terms



The chart also indicates that while the effect of asset disposals on net debt is pronounced, in the absence of subsequent disposals ie from 2001, there in minimal change — indeed the total rises in 2002 after which there is a steady decline. It is also apparent that unfunded superannuation liabilities are steady over the period. Details of unfunded superannuation liabilities are discussed later in this section.

Net Debt and Deficits

The primary factors that influence the net debt figure are:

- the annual surplus/deficit — a surplus will reduce debt and a deficit increases debt;
- asset sales — can affect net debt by exchanging physical assets for cash.

These are stated separately because of the Government's practice of presenting the annual surplus/deficit exclusive of asset sales. Audit believes this practice to be useful in understanding underlying and sustainable public sector financial operations.

The following table is designed to aid an understanding of the relationship between the net debt figures and the annual Budget results as published:

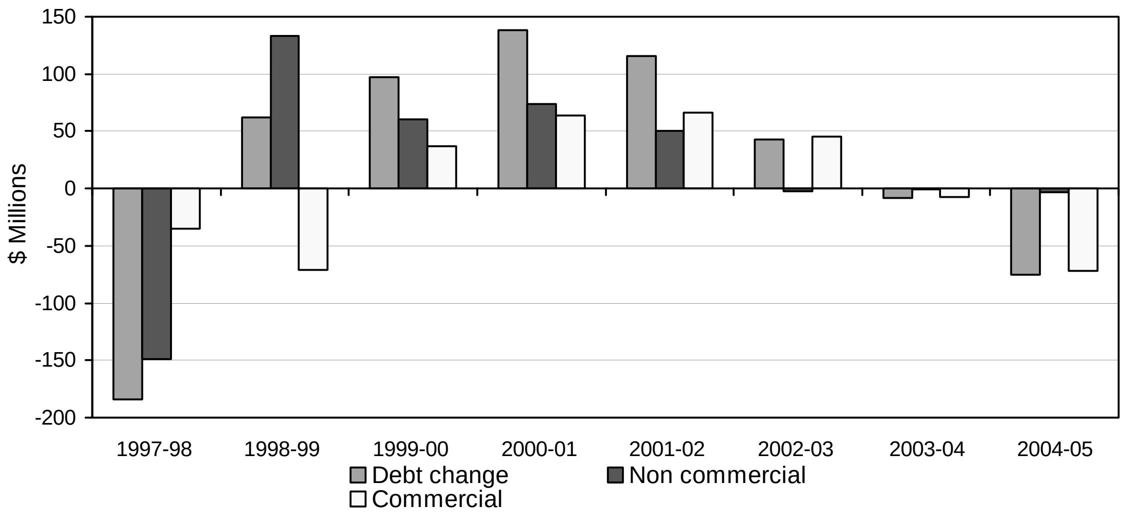
Reconciliation of Debt and Deficits (a)

	(1) Net Debt Level at End of Year (b) $'million	(2) Change in Debt in Year (a) $'million	(3) Non-Commercial Deficit $'million	(4) Commercial Sector Deficit $'million	(5) Sale of Government Businesses $'million	(6) Other Factors (c) $'million
1996-97	7 946	-	-	-	-	-
1997-98	7 589	-357	-149	43	-147	-104
1998-99	7 720	131	133	-71	-	69
1999-2000	4 355	-3 365	60	37	-3 671	209
2000-01 (d)	3 270	-1 085	74	64	-1 236	13
2001-02 (e)	3 392	122	50	66	-	6
2002-03 (e)	3 451	59	-2	45	-	16
2003-04 (e)	3 433	-18	-1	-7	-	-10
2004-05 (e)	3 356	-77	-3	-72	-	-2

(a) Total of columns (3) to (6) equals column (2) (—) means a surplus
(b) Nominal prices
(c) 'Other Factors' includes items such as changes in levels of unpresented cheques, effects of differences in classification of certain advances
(d) Estimated result
(e) Projections

The following chart shows the changes in debt exclusive of asset sales/disposals and other factors.

Debt and Deficits



The point to be noted from the table and chart is that notwithstanding the target of balanced budgets, the operations of the non-commercial sector have or are projected to, contribute to debt reduction in only one year (1997-98) up to 2003-04. In fact that was due only to a large special transfer from the South Australian Government Financing Authority.

The four years 1998-99 to 2001-02 either have or are projected to result in deficits in the non-commercial sector, adding $317 million to debt. Data tables suggest the borrowings primarily fund abnormal outlays.

Adding to that are deficits in the commercial sector in each of the four years from 1999-2000 to 2002-03 totalling $212 million. In total the deficits over these two periods add $529 million to net debt.

The final two years, 2003-04 and 2004-05, are projected to be consistent with the targeted balanced budgets for the non-commercial sector and for surpluses to be achieved in the commercial sector.

It might be noted that deficits in the commercial sector (now essentially SA Water Corporation) are generally regarded more kindly than in the non-commercial sector. This reflects the prospect that commercial sector debt will be serviced from business revenues rather than from general government revenues.

Debt Affordability and Servicing

The effect of changes in the level of net debt and unfunded superannuation liabilities over a number of years is reflected in the State's ability to service debt, and the cost of servicing debt to the exclusion of other purposes. The following shows through a number of ratios how the affordability and servicing of debt has changed or is projected to change over the next few years.

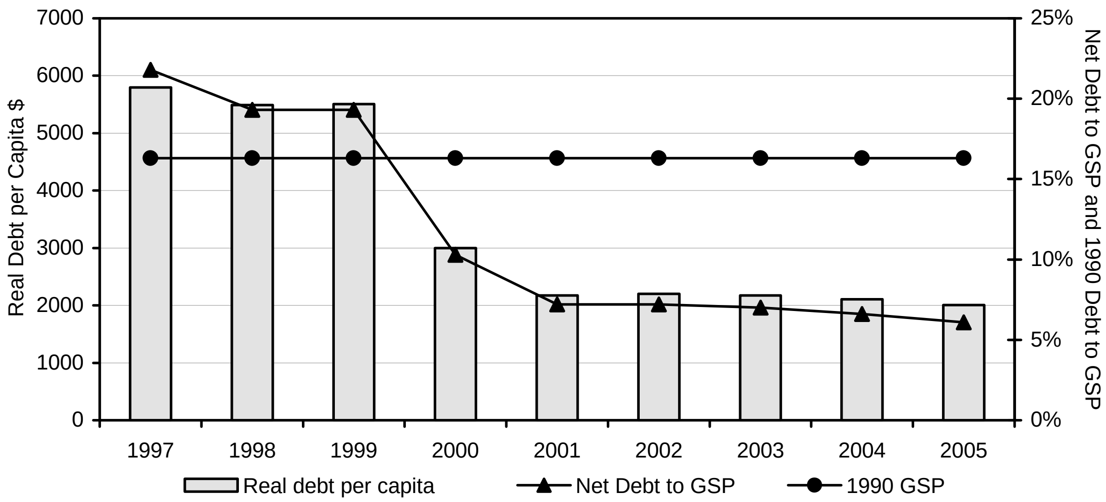
It should be noted that as ratios reflect the results of more than one variable factor, the trends could alter with adjustment to any of those factors. Some comment regarded as relevant is provided in the following commentary.

Net Debt to GSP and Per Person

An indicator widely used in financial markets is the ratio of State debt to State economic output — GSP. An indicator perhaps also of interest to the public generally is the value of net debt per person, that is, net debt per capita.

The chart below sets out the trend for these two indicators.

Net Debt to GSP (%) and Per Person ($) (Real Terms)



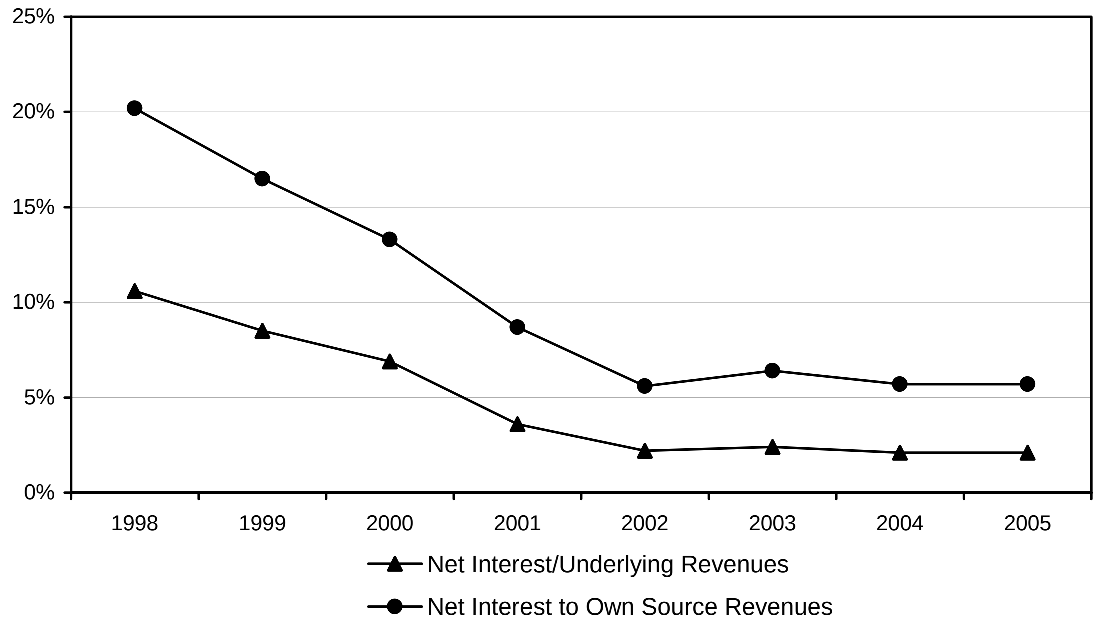
It is clear, the electricity asset disposals in 2000 and 2001 create a pronounced decrease in the ratios. Net debt to GSP is now well below that of 1990, before the effects of the State Bank collapse. The steeper decrease in the ratio of net debt to GSP than the per capita ratios reflects the higher experienced or projected growth of GSP compared to population growth over the same period.

Debt to Revenues and Net Interest Bite

The following indicators show the experienced and projected affordability of net debt by comparing net interest cost to State revenue measures:

- net interest cost to underlying revenues shows the proportion of total State revenues consumed in meeting net interest costs;
- net interest cost to own source revenues shows the proportion of State sourced revenues consumed in meeting net interest costs.

Debt Affordability Ratios (a)



(a) Underlying revenues are total revenues adjusted in 1999-2000 and 2000-01 for stamp duty receipts from electricity asset sales of $103 million and $39 million respectively.

The chart shows the following:

- net interest cost to revenue indicators show major decreases in 2000 and 2001 for the effects of asset disposal proceeds and a steadying thereafter as both projected net debt and underlying revenues change little over the forward years;
- net interest cost to own source revenues rises in 2003 due to an increase in net interest cost in that year while revenues are projected to be relatively steady.

Unfunded Superannuation Liabilities

Superannuation liabilities are regarded as unfunded when specific assets have not been set aside to meet superannuation liabilities as they fall due. It is now commonplace for governments to have a long-term funding strategy and this is the case in this State.[40]

Superannuation liabilities are determined on long-term estimates of total liabilities — they are not liabilities that will be called on in total in the immediate future — thus there is the ability to seek to fund them over forty years.

In estimating the liabilities, a range of variable factors are taken into account, key among them are assumptions of salary earnings, investment earnings on assets, inflation and demographic details such as mortality rates. Also important are the scheduled past service contributions by the Government. The Commonwealth Government also funds certain of the liabilities.

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40 It has been the policy of most Australian states until relatively recently, to fund superannuation benefits as they arise.

In relation to assets set aside to fund these liabilities, they are predominantly invested in such a way that the market value can be assessed at any point in time and the annual returns on investment are immediately added to the available assets. Returns on investments can have a very significant impact on the unfunded liability.

Independent Actuarial Review — September 2000

A detailed actuarial review of the ability of the public sector superannuation funds to meet their current and future liabilities is conducted every three years while updates to the estimated value of future payments, based on adopted assumptions, are made annually.

In September 2000 the Treasurer approved the adoption by the Department of Treasury and Finance of the assumptions[41] underlying the 1998 triennial review of the South Australian super schemes by an independent actuary.

Major financial changes resulted from this review, namely:

- a reduction in the annual accruing superannuation expense (new service) of about $15 million per annum;
- a reduction of $618.5 million in the balance of the unfunded superannuation liability.

Reductions, in the order of $40 million per annum, to the scheduled payments for the past service liability are also projected from 2004-05 as a result of the actuarial review and other factors including data/member detail updates.

The superannuation liability may change periodically as assumptions and experience change. This is an accepted fact for this type of liability. It is, however, important to understand that the change to liabilities in this instance results from a best estimate process based on assumptions and expectations based on past circumstances and performance in calculating the liability. It is not a physical reduction as in the case of debt retirement.

Significance of the Revision

The significance of the revision of the estimated liability is demonstrated in the following chart that sets out estimated unfunded superannuation liabilities and the estimated past service payments before and after the actuarial review.

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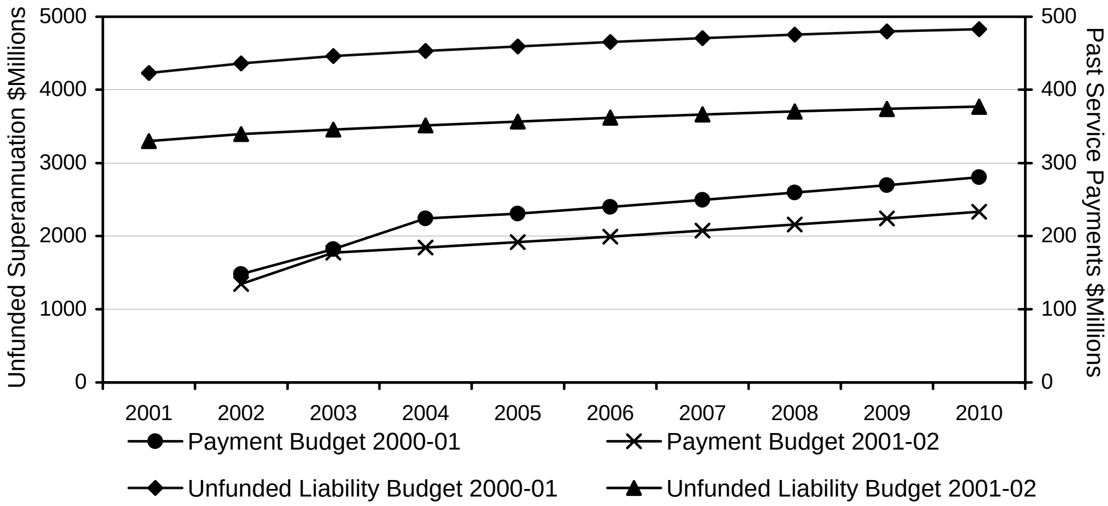
[41] See ‘Budget Statement 2001-02’, Budget Paper 3, p. 4.3.

Unfunded Superannuation Liabilities and Past Service Superannuation Payments



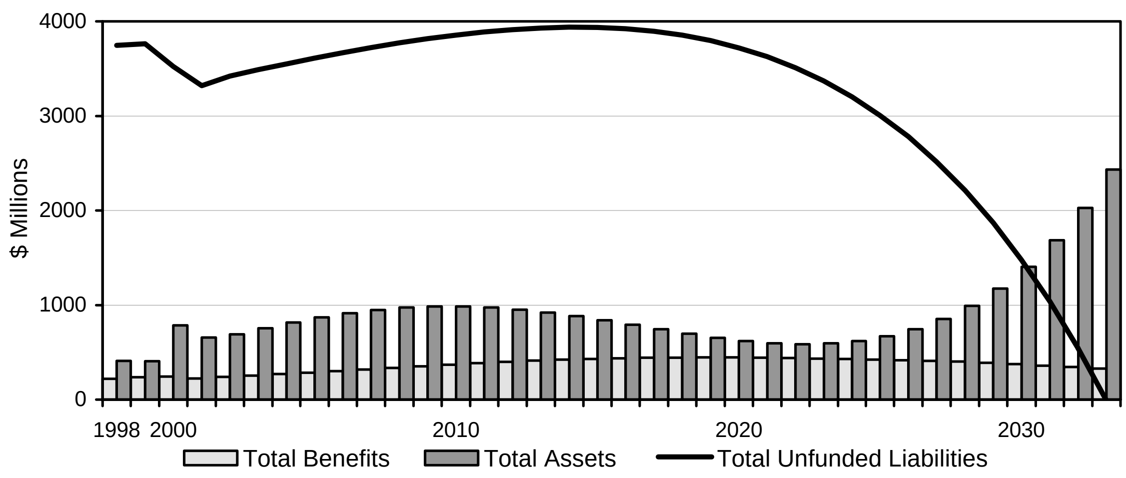
The key assumption taken into account in the actuarial review and affecting the estimated superannuation liability is the estimated real earnings rate. This was revised to 5 percent up from 4 percent previously reflecting the historic and anticipated earnings performance in relation to the assets of the superannuation funds.

As mentioned, the independent actuarial review is conducted triennially to review the assumptions and position of the superannuation assets and liabilities. Further details in relation to superannuation are presented in Part B of this Report under the SA Superannuation Board and the Superannuation Funds Management Corporation of South Australia (Funds SA).

Peak in Unfunded Superannuation Liabilities

The following chart shows the current estimates of benefits payments, assets and unfunded liabilities for superannuation for the State Scheme and the Police Superannuation Schemes — the major and unfunded schemes.

Superannuation Benefit Payments, Total Assets and Total Unfunded Liabilities (a)



(a) Data includes closed Pension and Lump Sum Schemes.

The State has a number of different schemes in operation and a number of schemes that are closed to new entrants.[42] The quoted total unfunded superannuation liabilities represent all of these schemes.

The chart shows that on current projections, unfunded liabilities are expected to continue to increase until peaking around the period 2012 to 2014. It is estimated that benefit payments will peak in 2018-19.

It is also apparent that the Government's target to fully fund superannuation liabilities by 2034 is on track on these estimates.

Other Liabilities

Other liabilities include provisions for other employee entitlements (in particular long service leave provisions), workers compensation, and other liabilities of entities including outstanding insurance claims.

The following table shows the value of liabilities estimated for 2000-01 and 2001-02.

Non-Financial Public Sector Other Liabilities

	2000-01 $'million	2001-02 $'million
Other employee entitlements and provisions	919	944
Other non-equity liabilities	967	985
Total	1 886	1 929

Significant balances in these liabilities include amounts that are subject to estimations processes similar to that applying to the estimation of superannuation liabilities. For 2000-01 and 2001-02 they include:

- long service leave provisions amounting to $634 million for 2000-01 and $656 million in 2001-02. Long service leave is calculated on an estimations process in most cases subject to guidelines issued by the Department of Treasury and Finance;
- workers compensation totalling $147 million for 2000-01 and $146 million in 2001-02;
- outstanding claims for SAICORP estimated at $180 million for 2000-01 and $176 million in 2001-02.

[42] Details of the majority of the State's superannuation liabilities and assets are included in Volume III of Part B of this Report under the heading 'SA Superannuation Board'.

Contingent Liabilities

As reported in the Budget Papers,[43] contingent liabilities are those that have not been recognised in the statement of financial position, but rather in notes to the accounts, for one of the following reasons:

- there is significant uncertainty as to whether a sacrifice of future economic benefits will be required;
- the amount of the liability cannot be measured reliably;
- there is significant uncertainty as to whether an obligation presently exists.

Contingent liabilities of the Government can arise from:

- legislative provisions requiring the Government to guarantee the liabilities of public sector organisations eg financial institutions;
- the ordinary activities of the Government might give rise to disputes and litigation that remain unresolved at any given balance date.

Guarantees and contingent liabilities of the Government of South Australia as at 30 June 2000 were valued at $1.9 billion. This is at nominal values without adjustment for the probability of actual liabilities occurring.

SOUTH AUSTRALIA'S FINANCIAL POSITION RELATIVE TO SOME OTHER STATES

The following sets out a commentary on measures of the State's financial position relative to some other States. Data is taken from the budget papers of the States included.[44] The ABS adopted accrual based reporting in 1999-2000; trends data commences from that year. Data presented represents the General Government Sector as defined by the ABS.[45]

Net Debt versus other Measures

Net debt has been defined previously. It has also been noted that net debt and unfunded superannuation liabilities are similar liabilities. Accordingly, to focus only on net debt will not necessarily provide a reader with an appropriate indicator of financial position. The following discussion incorporates measures of net worth, net financial worth and non-financial assets per capita.

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43 Budget Statement 2001-02, Budget Paper 3, p. 7.6.

44 Western Australia is not represented, as its budget had not been released at the time of preparing this Report.

45 The general government sector represents all government departments and agencies that are mainly financed from consolidated revenues. It excludes all corporations mainly providing market goods or non-financial services.

Some Qualifying Observations Concerning the Ratios

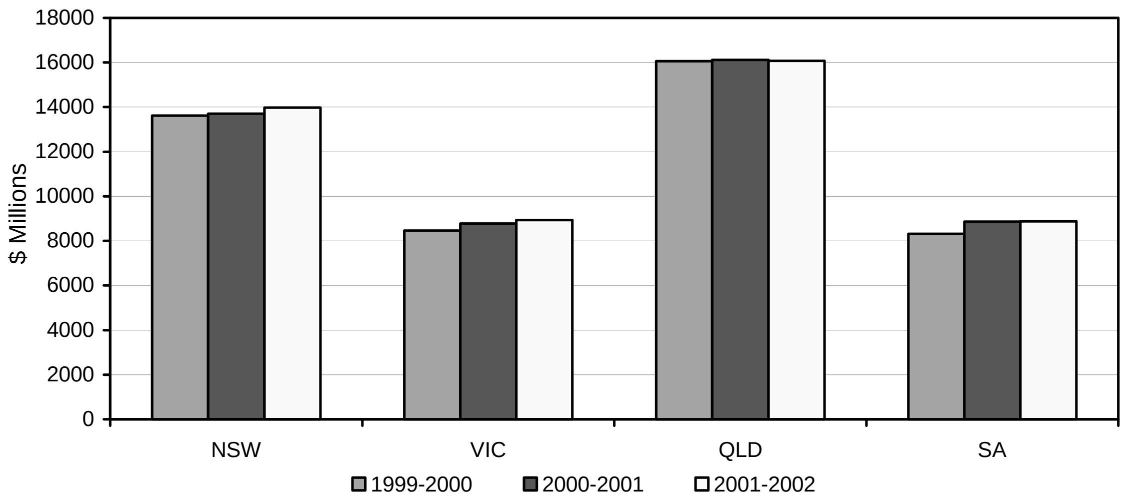
Before considering the ratios, a number of observations might be made as to their usefulness. The purpose of the ratios is to draw attention to relative differences between jurisdictions. No suggestions are made as to what is regarded as optimal. However, significant variations would warrant consideration as to the related implications.

There are a number of points that should be noted in regard to the value of non-financial assets reported by jurisdictions. These values can reflect varying valuation approaches between States and higher asset values can also reflect higher infrastructure needs for population differences. Higher asset values can be associated with higher debt levels. A final observation is that infrastructure can be provided through the private sector and therefore not be included in government data.[46]

Net Worth Per Capita

General Government net worth is calculated as total assets (physical and financial) less total liabilities (debt, superannuation, other) and therefore highlights the net change in these items. Financial assets include the equity of public non-financial corporations and public financial corporations held by the general government sector. As an indicator, net worth is subject to the influence of valuations of assets, which can vary widely for a range of reasons — eg markets, methods adopted. Changes in net worth arise from transactions — the operating result, and from revaluations of assets and liabilities. The following chart plots the Budget data.[47]

General Government Net Worth Per Capita



The positions of South Australia and Victoria stand out. Differences arising between the State's reflect the histories of policy decisions made and financial outcomes. More

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[46] A discussion of issues on comparing asset positions between States is provided in 'Budget Statement 2000-01' Budget Paper 2, p. 7.2 to 7.4.

[47] Note that population numbers for 2000-01 and 2001-02 are based on ABS population projections.

particularly, South Australia and Victoria suffered major losses in relation to financial institutions that severely eroded their net worth. Both States have also had major asset disposal programs.

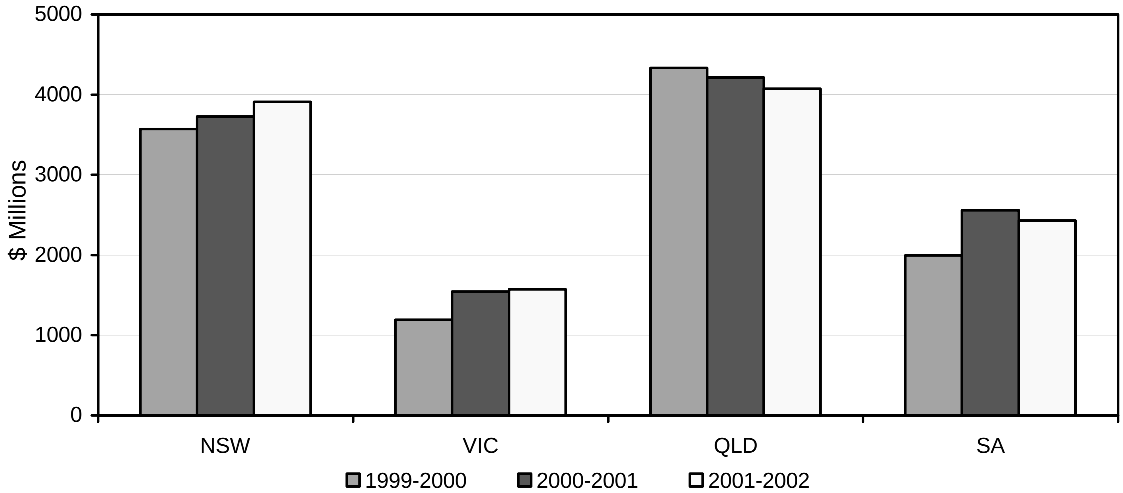
The data suggests that the States with the higher net worth have additional assets for provision of services or disposal notwithstanding differences that might arise from measurement issues. The differences between the high and the low are very significant and for example for South Australia to reach the average of the four States for 2001-02 would require additional net assets in the order of $6 billion or 25 percent of existing assets.

Net Financial Worth

Net financial worth[48] is a measure that is determined by total financial assets less total liabilities. It is a broader measure than net debt and captures changes in other liabilities when observing trends and comparing between jurisdictions.

The following chart plots the Budget data.

General Government Net Financial Worth per Capita



The results are consistent with the trends for net worth. The Budget Papers[49] indicate that the improvement in South Australia's financial net worth in 2000-01 is a result of an accounting gain on disposal of the electricity assets and the beneficial impact of superannuation asset earnings in 1999-2000. The slight fall projected for 2001-02 for South Australia is due to projected increases in borrowings and superannuation liabilities. For South Australia to reach the average of the four States for 2001-02 would require additional net financial assets in the order of $1.1 billion or about 10 percent of existing assets.

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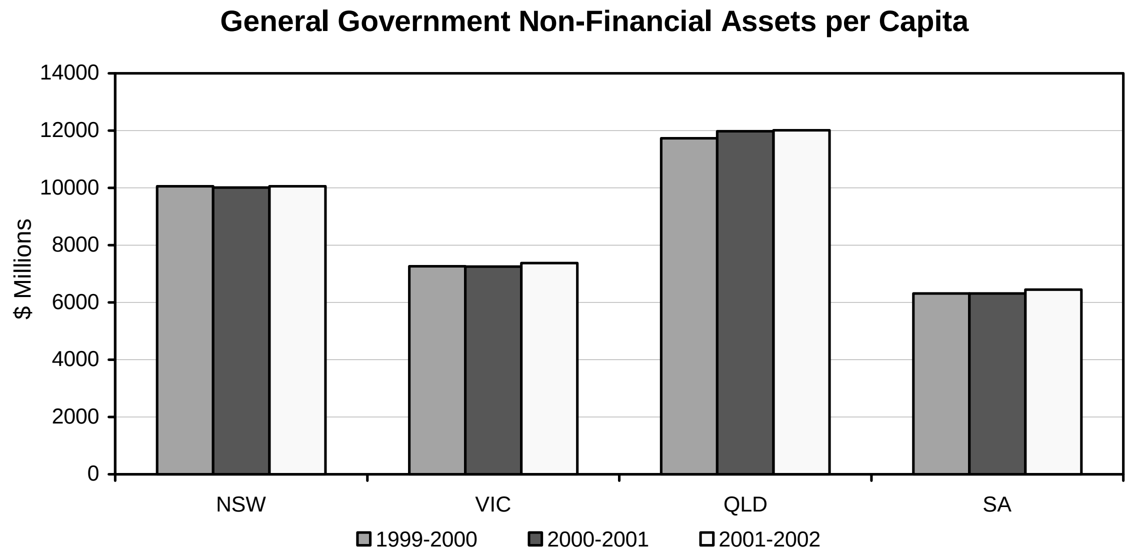
48 The South Australian and New South Wales Budget Papers note that net financial worth is a useful indicator for examining the soundness of a government's fiscal position, particularly as a benchmark against itself over the medium-to-long term.

49 Budget Statement 2001-02, Budget Paper 3, p. 7.6.

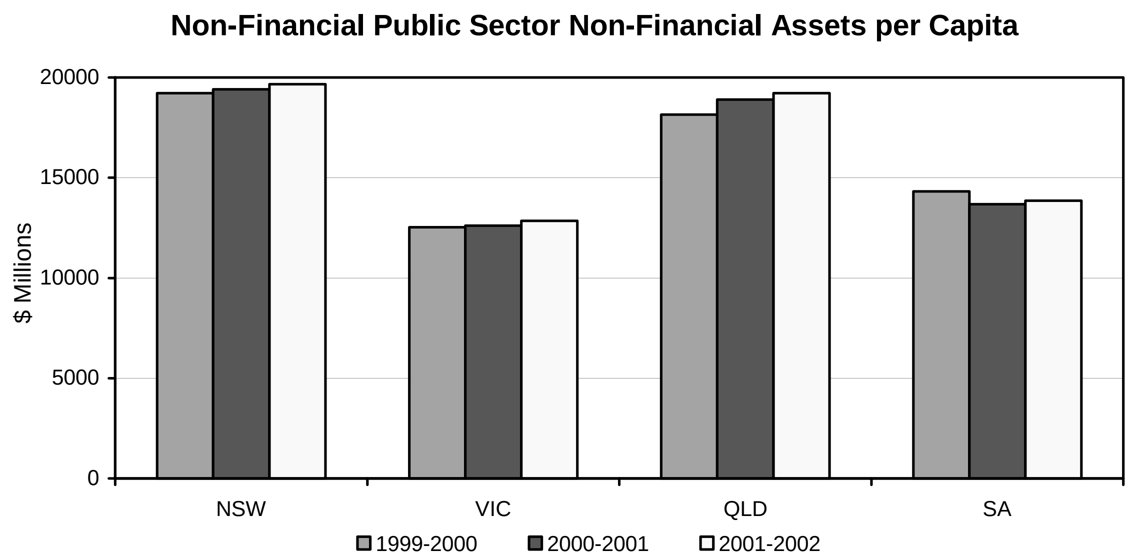
Non Financial Assets Per Capita

Non-financial assets are virtually all land and fixed assets including buildings, infrastructure and plant and equipment. The following chart plots the Budget data.



The chart indicates that the preceding ratios for net worth and financial net worth align with the non-financial asset ratio. Again it suggests the States with higher ratios have substantial additional assets at their disposal. For South Australia to reach the average of the four States for 2001-02 would require additional non-financial assets in the order of $5 billion or about 50 percent of existing non-financial assets.

A somewhat different result is obtained, however, when looking at the non-financial public sector data. The following chart plots the Budget data.



This chart shows that South Australia has higher non-financial assets per capita than Victoria and relatively better placed against NSW and Queensland. The effect of the disposal of the electricity assets in 2000-01 is also apparent. For South Australia to reach the average of the four States for 2001-02 would still require additional non-financial assets in the order of $5 billion or about 25 percent of existing non-financial assets.

The nature of government financial reporting of fixed assets in particular suggests that no firm conclusion should be drawn from the ratios without a good understanding of the nature of differences. The ratios are included in this Report because of the significant differences between the high and low States.

Summary of the State's Relative Position

The data suggests that the States with the higher ratios have additional assets for use or disposal notwithstanding differences that might arise from measurement issues.

The differences between the high and the low are very significant and for example for South Australia to reach the average of the four States for 2001-02 would require significant additions to net assets should this be regarded as desirable. Given the complete achievement of such targets would be unattainable except perhaps over a very long time frame, the differences emphasise the need for South Australia to maximise the efficiency with which it uses its existing resources. It also emphasises the importance of maintaining prudent and effective risk management activities particularly against the incurrence of future major liabilities.

Before the electricity asset disposals, the State had debt levels and associated burdens that were generally considered to be too high. A major reduction to net debt has occurred and the State's exposure to debt burdens has been reduced. Capitalising the value of the electricity businesses and retiring debt achieved this. This action has had some but not a large impact on the ratios described.

DEBT MANAGEMENT — GENERAL

Past Reports have discussed debt management issues in considerable detail with a focus on matters relevant to the determination of policy and on performance. The following sets out the current status of policy related matters and performance in the light of the asset disposals.

Change in Debt Management Policy

A Government review of debt management policy was discussed at length in the previous Report. During 2000-01 the Treasurer changed the policy benchmark duration from 2.8 years to in between 1 to 1.5 years. This means that in practice the average maturity of the debt portfolio will be lower than it previously was. As noted in my last Report, the lower duration benchmarks offer lower average interest costs over the long-term but with possible higher short-term budget volatility.

Debt Management Performance in Recent Years

The following table, as in past Reports, sets out data on debt management performance over a number of years.

Market Value Cost of State Debt (a)

Time Period	Actual Portfolio Percent	Benchmark Portfolio (c) Percent	Floating Benchmark Portfolio Percent	Long-Term (10 Year Bond) Benchmark Portfolio Percent
1992-93	11.1	14.4	n/a	n/a
1993-94	3.6	0.5	n/a	n/a
1994-95	11.4	12.4	n/a	n/a
1995-96	9.4	9.1	7.7	11.9
1996-97	13.5	13.5	6.9	23.5
1997-98	8.4	8.7	5.0	18.1
1998-99	4.2	4.3	5.1	0.8
1999-2000	6.2	5.9	5.4	7.4
2000-01	7.4	7.9/7.5	6.0	6.5
Three years 1998-99 to 2000-01 (b)	5.9	6.0/5.9	5.5	4.9
Four years 1997-98 to 2000-01 (b)	6.5	6.7/6.6	5.3	8.0

(a) Data provided by Department of Treasury and Finance and represents debt managed by SAFA on an active basis and does not include debt managed on a passive basis (eg CPI indexed debt and Commonwealth State Housing Agreement Debt). It also does not include all government entities. Actual portfolio reflects the performance in respect of the actual debt portfolio. All other portfolios are hypothetical scenarios, eg Benchmark portfolio reflects the performance of a hypothetical benchmark of debt.

(b) Figures for the cost of funds shown here reflect annual rates.

(c) Duration of 3.2 years to December 1995, 2.75 years to June 1996, 2.8 years until November 2001 and then a range of 1 year to 1.5 years benchmark portfolios.

The table shows the combined effects of the move to the shorter benchmark duration and the completion of the management of the proceeds from the electricity asset disposal proceeds in 2000-01. The cumulative market value cost of funds for the Treasurer's portfolio was 7.4 percent compared with the range 7.9 to 7.5 percent for the benchmark. The previous year performance was influenced by the requirement to manage (including hedging) the proceeds from electricity asset disposals.

The table also continues to show the cost differential between shorter (in the table floating) benchmarks and longer (10 year bond) benchmarks demonstrating the cost trade-off aspect in relation to debt management policy over the long-term. It also shows the short-term fluctuations possible.

CONCLUSIONS

Reduction in Net Debt and Unfunded Superannuation Liabilities

There has been a major reduction in the order of $1 billion in net debt in 2000-01. This has been due entirely to the physical retirement of debt using the proceeds of asset disposals. Over two years the reduction has been $4.5 billion. Operating deficits in the past two years have reduced the effect of the decrease.

This is a major change in the State's financial position in as much as exposure to the burdens of net debt is reduced — following the exchange of the income earning assets of the electricity businesses that were themselves subject to a variety of operational risks, for cash. Interest costs now consume 3.6 percent of non-commercial sector underlying revenues compared to 10.6 percent in 1997-98.

With the addition of a reduction in unfunded superannuation liabilities of $242 million in 2000-01, following an independent actuarial assessment (resulting in a $618.5 million decrease), the overall decrease of net debt and unfunded superannuation liabilities in 2000-01 is in the order of $1.3 billion.

The major part of remaining net debt resides in the public non-financial corporations sector.

Projected Movements in Net Debt and Unfunded Superannuation Liabilities

The forward estimates indicate that both net debt (due to operating deficits) and unfunded superannuation liabilities are to rise from their 2000-01 levels for the next two years but that in real terms, there will be a steady fall over the four year forward estimates.

The Government is on track to meet its target of fully funding superannuation liabilities by 2034.

The Position Relative to Other States

The data suggests that having achieved some improvement in financial indicators, South Australia remains significantly below the average in terms of financial strength ratios for four major States. This emphasises the need for the State to maximise the efficiency with which it uses its existing resources and for strict risk management processes in protecting against the incurrence of large liabilities in the future.

Debt Management

Following the significant change to the State's financial position the Department of Treasury and Finance has implemented a revised debt management policy being a lower policy benchmark duration than in the immediate past. While continuing to meet the Treasurer's policy requirements, the revisions to policy provide the opportunity for lower ongoing interest and administrative costs in the future, notwithstanding the reduced level of net debt.

THE TREASURER'S FINANCIAL STATEMENTS FOR THE PERIOD ENDING 30 JUNE 2001

INTRODUCTION

In my view, the more relevant data for an overall analysis of public finances is that prepared by the Australian Bureau of Statistics method and presented as the non-commercial and commercial sectors together with whole-of-government financial statements prepared in accordance with Accounting Standards. Bearing in mind that observation, this section of the Report considers the results and the financial position reported in the Treasurer's Financial Statements for the year ending 30 June 2001 that have been audited and are reported on in the Letter of Transmittal to this Report.

The Report covers the principal accounts of the State Government, that is, the Consolidated Account, the Special Deposit Accounts and Deposit Accounts, through which specific operations of government are conducted. This is consistent with the requirements of the *Public Finance and Audit Act 1987*. The Treasurer's Financial Statements are reported, in full, as an Appendix to this Report Part B Volume III.

APPROPRIATION AUTHORITY

Reporting on the result of the Consolidated Account remains important as it is through this Account that, pursuant to the requirements of the *Public Finance and Audit Act 1987*, a high proportion of public monies are received and expended. The main receipts to this Account are State taxation and Commonwealth general purpose grants to the State. The importance of reporting derives from the fact that funds in this Account can be expended only by Parliamentary appropriation. Reporting therefore establishes the actual sources and application of Consolidated Account funds.

The Treasurer's Financial Statements set out the appropriation authority available from various sources for the financial year including the annual Appropriation Act, the Governor's Appropriation Fund[50] and specific appropriation authorised under various acts. Also set out are the purpose and amount of payments from the Consolidated Account, ie the use of that appropriation.

Total appropriation authority for 2000-01 was $6 203 million.[51] Actual payments were $5 894 million, well within appropriation authority.

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50 Section 12 of the *Public Finance and Audit Act 1987* provides that the Governor may appropriate to the public purposes of the State from the Consolidated Account in any financial year, an amount not exceeding three percent of the total of the amounts set out in the annual Appropriation Acts in respect of the previous financial year.

51 Statement K — Statement of Appropriation Authorities, Appendix to Part B Volume 3 of this Report.

Appropriation authority under the annual appropriation act and Governor's Appropriation Fund, lapse on 30 June each year pursuant to the relevant legislation notwithstanding the availability of unused appropriation.

THE CONSOLIDATED ACCOUNT OUTCOME

The result on Consolidated Account for 2000-01 was a deficit of $150.8 million ($217.5 million in 1999-2000). The deficit was determined after receipts of $5.7 billion (budget $5.8 billion) and payments of $5.9 billion (budget $5.9 billion).

The deficit was financed by borrowings from SAFA.

The key differences between budgeted and actual figures were:

- an increase in taxation receipts of $150 million due mainly to an increase in stamp duty receipts of $97.9 million over budget. This includes $39 million from the disposal of electricity assets;
- an increase in Commonwealth general purpose grant receipts of $55.9 million;
- payments amounting to $30 million towards prepaying interest expenses for 2001-02;
- deferral of receipts from the South Australian Asset Management Corporation and the South Australian Government Financing Authority with a total effect of $177 million. These receipts were not required by the Government for the 2000-01 year and have been held over to future budgets;
- royalties exceeded budget by $34.8 million and totalled $106.6 million.

Full details of the budget and actual data are presented in Statement A 'Comparative Statement of the Estimated and Actual Receipts and Payments to the Consolidated Account'.

THE CONSOLIDATED ACCOUNT DEFICIT

The cash deficit of $150.8 million exceeded budget by $47.3 million. The size of the deficit, however, overstates its significance to the extent that it represents only a section of the overall budget result as described in the earlier sections in this Part of the Report.

It is important to emphasise that cash movements here are consolidated with other cash movements in the non-commercial sector but outside of the Consolidated Account. For 2000-01 the estimated net result is that the non-commercial sector will have an underlying cash surplus of $2 million for 2000-01. Cash surpluses outside of the Consolidated Accounts are reflected in the cash position of the Treasurer's Financial Statements explained later in this section.

APPROPRIATION FLEXIBILITY

While there is specific appropriation authority established under various legislation there is in fact very broad flexibility in the existing appropriation arrangements in this State. A significant aspect in this regard is that most appropriation from the Consolidated Account is transferred to Special Deposit Accounts and Deposit Accounts established pursuant to the *Public Finance and Audit Act 1987*. Under related provisions, monies credited to those accounts can be spent without further appropriation from Parliament. This is of significance in that monies appropriated in one year and transferred to a deposit account need not actually be expended in that year, that is, they may be carried over into the next year.

Such unspent balances do come under the scrutiny of Parliament in as much as they are reported in the financial positions of agencies in the budget papers. The next section provides further comments on the cash position as recorded in the Treasurer's Financial Statements.

Governor's Appropriation Fund and Contingency Provisions

Other key aspects of flexibility in appropriation authority arise from the provision of sources of funds for additional/new initiatives or unforeseen cost pressures that can be used without a requirement to return to Parliament for additional appropriation authority. The two such sources generally now used are the:

- Governor's Appropriation Fund (GAF) previously mentioned, which adds to the amount appropriated by Parliament each year;
- contingency provisions for employee entitlements, supplies and services and plant and equipment in the total of the appropriation purpose 'Administered Items for Department of Treasury and Finance'.[52] These amounts are included within the total appropriation but are generally not committed to a specific purpose at the time of the budget.

Prior to 1998-99 only the GAF was available. The 2000-01 Budget included contingency funds totalling $172.1 million, which when added to the $174.8 million available from the GAF provided uncommitted flexibility within the budget of $346.9 million or 5.6 percent of the total of the *Appropriation Act 1999* and the GAF.

Use of the contingency provisions is on a similar basis to the GAF with the Treasurer approving the expenditure of funds.

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52 *Appropriation Act 2000* Schedule. Details in 'Portfolio Statements 2000-01 Budget Paper 4 Volume 1' pp. 3.23 and 3.24.

The following table sets out the availability and use of these funds in 2000-01.

	Authority $'million	Actual Payments $'million
Governor's appropriation fund	174.8	114.7
Total contingency provisions	172.1	135.4
Total flexibility	346.9	250.1

Details of the purpose of the actual payments from the GAF are provided in Statement K.

Details of payments from the contingency funds are not disclosed in the Treasurer's Financial Statements. Payments are transfers of additional funding to agencies. These payments are included within the total payments from the line 'Administered Items for Department of Treasury and Finance' in Statement A.

SUMMARY OF THE CASH POSITION OF THE TREASURER'S FINANCIAL STATEMENTS

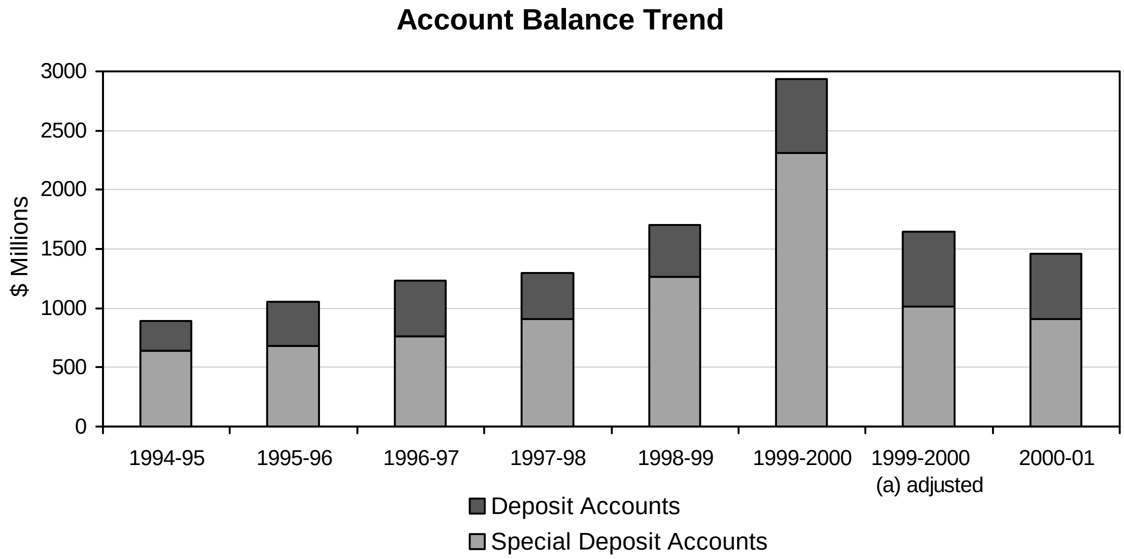
The Treasurer's Financial Statements report the cash position of the various accounts that the Treasurer is empowered to operate pursuant to the *Public Finance and Audit Act 1987*.

These balances do not purport to represent the total cash position of the public sector. The following table does, however, indicate the cash position of agencies included in the Treasurer's ledgers and these are the majority of government agencies.

The following table shows the balances of the Accounts (Statements F and G) of the Treasurer over the past seven years.

Year	Deposit Accounts $'million	Special Deposit Accounts $'million	Total Cash $'million
1994-95	249	644	893
1995-96	371	682	1 053
1996-97	469	766	1 253
1997-98	390	911	1 301
1998-99	436	1 266	1 702
1999-2000	631	2 308	2 939
2000-01	**545**	**912**	**1 457**

The following chart highlights the trend in account balances over the period.



(a) 1999-2000 adjusted to exclude the balance of the Electricity Sale/Lease Proceeds Account.

The decrease in total cash funds as at 30 June 2001 of $1 482 million from the previous year is predominantly related to the completion of the debt retirement program, with the remaining electricity asset disposal proceeds being applied to the Treasurer's debt with SAFA in 2000-01. It also represents the sum effect of a number of significant increases and decreases in other balances over the year. In view of the impact of the unused electricity asset disposal proceeds, two sets of data are presented for 1999-2000 in the chart. The 1999-2000 adjusted figure excludes the balance of the Electricity Sale/lease Proceeds Account. That adjustment shows that overall there is a slight decrease in other cash balances.

The key changes were the following:

- the balance of the Electricity Sale/Lease Proceeds Account decreased by $1 292 million. This reflects the use of proceeds for debt retirement;
- related to this account was the decrease of $36 million in the balance of the 'Electricity Reform and Sales Operating Account', the account for all the transactions in relation to the Electricity Reform and Sales Unit. This is predominantly in relation to the disposal of electricity assets. The operations of this unit are discussed further in Part B of this Report;
- the decrease in the South Australian Superannuation Fund Account (SASF) of $102 million was evident as a result of a final adjustment to superannuation funding not being made against the account this year compared with previous years. Adjusting payments for superannuation are discussed in the section of this Part of the Report titled 'An Overview of the State's Finances';
- other sizeable decreases in cash balances were noted for the Superannuation Funds Management Corporation ($75.7 million); Industry and Trade ($42.5 million) and Asset Sales ($34.6 million) operating accounts;

- these decreases were offset by significant increases in other cash balances. The balance of the Administrative and Information Services operating account increased by $96.7 million to $229.5 million and the 'Accrual Appropriation Excess Funds' continues to accumulate, increasing by $29.4 million to $150 million. The balance of the 'Accrual Appropriation Excess Funds' account represents funds appropriated from the Consolidated Account, which are not accessed until required by agencies for the purposes for which they were appropriated; that is, to meet employee long service leave or capital expenditure funded by an annual depreciation expense.

Details of these accounts are set out in Statements F and G of the Treasurer's Financial Statements for 2000-01.[53] Statement C — 'Funds of the Treasurer as at 30 June 2001' shows the disposition of these funds as cash and investments with SAFA.[54]

INDEBTEDNESS OF THE TREASURER

The other significant change in the Treasurer's Financial Statements in 2000-01 is reported in Statements I and J in relation to the Indebtedness of the Treasurer and the financial relationships and transactions between the Treasurer and SAFA.

Following the disposal of electricity assets in 1999-2000 and various smaller transactions, there has been a net reduction of $2.1 billion or 35.8 percent in the balance of the Indebtedness of the Treasurer to SAFA from $5.9 billion to $3.8 billion.

The items comprising the net change are set out in Statement J as follows:

	$'million	**$'million**
Balance at 30 June 2000		5 853
Add: Consolidated Account borrowing in 2000-01	151	
Add: Assumption of electricity entity debt	306	
Add: SAFA book gains/losses (net)	5	
Less: Repayment of borrowings	2 550	
Less: Other minor adjustments (net)	10	
Net Decrease		(2 098)
Balance at 30 June 2001		3 755

Further comment in relation to the changes in indebtedness are set out in the section of this Part of the Report titled 'State Debt and Other Liabilities'.

53 Statement F — Special Deposit Accounts and Statement G — Deposits Lodged with the Treasurer, Appendix to Part B Volume III of this Report.

54 Statement C shows the balances of the two deposit accounts together with cheques drawn but not presented at 30 June 2001 and the disposition of total funds.

WHOLE-OF-GOVERNMENT FINANCIAL STATEMENTS

INTRODUCTION

For a number of years I have commented on the need for the continuing enhancement of information presenting the State's financial position.

Such information is available from two sources. Firstly, in a previous section of this Report I have provided commentary using the 'Government Financial Statistics' (GFS) data coordinated by the Australian Bureau of Statistics. The GFS data includes information on a government's operating performance and financial position within different sectors. Secondly, the government elects to prepare whole-of-government financial statements in accordance with Australian Accounting Standard AAS 31 'Financial Reporting by Governments' (AAS 31), which provides a consolidated picture of the finances controlled by the Government.

This section of the Report provides a review of the preparation of the AAS 31 Financial Statements for the year ended 30 June 2000, together with an analysis of those statements. Because the timing of the tabling of this Report in Parliament is before the annual whole-of-government financial statements can be finalised for the immediate past year (ie 2000-01), the commentary and data referred to is in relation to the 1999-2000 year. Accordingly, the commentary is brief.

BACKGROUND

As mentioned above, the basis for preparation of the whole-of-government financial statement is AAS 31, which has applied to all Australian Governments for the reporting periods ending on or after 30 June 1999.

Previously, I have reported that there is presently no requirement under the *Public Finance and Audit Act 1987* or other legislation to provide an independent audit opinion on the preparation of whole-of-government financial statements. Therefore, until relevant legislative provisions are passed, I am unable to issue a formal independent audit opinion on the Financial Statements. With respect to this matter, Audit understood that this issue may have been addressed as part of an ongoing review of the *Public Finance and Audit Act 1987*. The Department of Treasury and Finance (DTF) have advised, however, that an initial review of the Public Finance and Audit Act has been undertaken, and that no further work is contemplated in the immediate future.

I consider the whole-of-government financial statements an essential component of the various information presented on the State's finances and financial position and are useful to management, governing bodies and other users for making and evaluating decisions about the allocation of scare resources. Further, the accrual based whole-of-government financial statements provide a mechanism for additional information to be provided to users in addition to traditional cash based information.

It is over time, through the ability to make a trend analysis of financial performance and financial position, that these statements become an important public sector financial management tool.

Therefore, although there is no mandate for the Auditor-General to issue a formal independent audit report in respect of such information, I consider it both valuable and within the ambit of wider public expectation that such financial information should be subject to some form of independent review regarding its credibility and validity. As a result, sufficient work has been undertaken to be able to provide the following observations in respect to the financial statements for the year ended 30 June 2000.

AUDIT REVIEW OF THE CURRENT REPORTING PROCESS

Scope of Review

The Government economic entity comprised all sectors of State Government activity, namely:

- general government (government departments);
- public trading enterprises;
- government controlled financial institutions;
- other government controlled entities.

The basis for consolidation was Australian Accounting Standard AAS 24 'Consolidated Financial Reports', which details the principles for determining what makes up the economic entity. As a result of using the control concept from the standard, the accounts exclude local government bodies, universities, most marketing and professional regulatory authorities, the Legislature, and associations and financial institutions incorporated under State statute but not controlled by the Government.

The key features of the audit undertaken of the financial statements included a review of:

- the principles adopted in the definition of the economic entity for whole-of-government purposes;

- controls and procedures within the DTF for evaluating the reliability and validity of data forwarded by agencies in their Data Collection Sheet (DCS) returns;

- the adequacy and reliability of the database used for the preparation of the whole-of-government financial statements;

- the preparation of the whole-of-government general purpose financial statements;

- compliance with appropriate legislation and accounting frameworks, in particular Australian Accounting Standards, Urgent Issue Group Consensus Views, Treasurer's Instructions and other professional reporting requirements.

Audit Findings and Comments

Following the review of the Financial Statements by Audit, a management letter was forwarded to the DTF in March 2001 that contained important reporting and operational considerations that would need to be addressed in order to provide an unqualified audit opinion should legislative changes precipitate the need to provide an audit opinion. The Audit management letter was reproduced in full in the whole-of-government financial statements published by the DTF.

The matters raised included:

- the whole-of-government financial statements excluded certain entities that Audit considered should have been included. Therefore the Financial Statements do not include all revenues, expenses, assets and liabilities controlled by the Government;

- some of the individual entities consolidated did not have audited information available;

- the inclusion of a number of material account balances from government entities that received qualifications;

- the need to improve procedures when verifying agency prepared data for inclusion in the financial statements;

- recommendations for disclosure and presentation improvements when preparing future whole-of-government financial statements;

- timeliness issues with the preparation of whole-of-government financial statements. In particular, it was noted that a number of other States had been able to finalise and publish their whole-of-government Financial Statements a number of months before South Australia.

Departmental Response

The Department responded positively to the issues raised above and expected to resolve most issues in time for the Financial Statements for the year ended 30 June 2001.

INTERPRETATION AND ANALYSIS OF FINANCIAL STATEMENTS

Due to the timing of the preparation of the whole-of-government financial statements, the last completed statements relate to the year ended 30 June 2000, and the following commentary has therefore been kept purposely brief.

Operating Result

The following summarises the operating result achieved by the State for the 1999-2000 financial year, as disclosed in the whole-of-government financial statements. Comparative figures for 1998-99 have been provided for identifying material movements in account balances.

	2000 $'million	1999 $'million
Revenues		
Taxation	2 081	1 729
Grants	3 925	3 697
Sale of goods and services	3 788	3 964
Investment revenues	1 552	1 048
Other	593	590
	11 939	11 028
Expenses		
Employee expenses	3 298	3 660
Supplies and services	3 149	2 814
Grants and subsidies	1 497	1 387
Interest and other finance expenses	2 119	1 554
Other	1 908	1 953
	11 971	11 368
Operating deficit from ordinary activities	(32)	(340)
Extraordinary items	1 119	-
NET SURPLUS (DEFICIT)	1 087	(340)

Revenue

Total revenue for the 1999-2000 financial year was $11.9 billion; an increase of approximately $900 million on the revenues earned in the 1998-1999 financial year. The increase was due mainly to:

- ***Taxation Revenue*** — increased by $352 million due primarily to the introduction of the Emergency Services Levy and an increase in stamp duties attributed principally to the inclusion of amounts received from the disposal of the State's electricity businesses.

- ***Investment Revenue*** — increased by $504 million due to gains on sale of investments and gains on revaluation of investments. This has resulted from devaluations in the Australian Dollar, and investment portfolios containing international and domestic shares, which experienced healthy returns during the 1999-2000 year.

In addition, an extraordinary revenue item was received, due to profits made on disposal of government-owned electricity businesses. This figure comprises the consideration received from the businesses, less the book value of the net assets sold or leased. Further gains are expected to be recognised in the 2000-01 financial year from the finalisation of the disposal of the State's remaining electricity businesses.

Expenses

Total expenses have increased by $603 million during the 1999-2000 financial year. This included an increase in interest and finance expenses of $565 million due to:

- an increase in the imputed interest amount on superannuation fund deposits ($429 million);
- book losses made from the early retirement of debt using the proceeds received from the electricity businesses disposal process.

Statement of Financial Position

The following summarises the financial position for the 1999-2000 and 1998-1999 financial years.

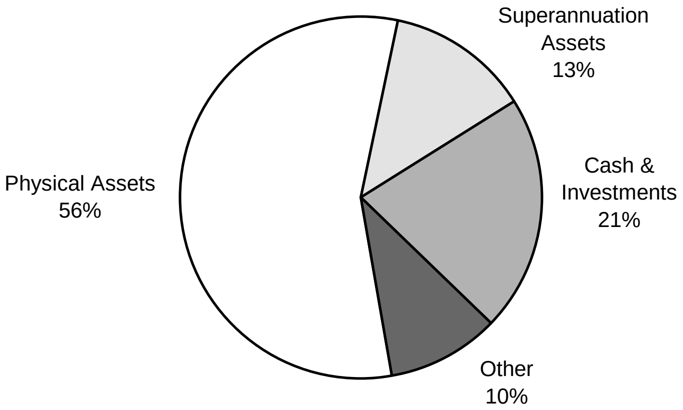
	2000 $'million	1999 $'million
Assets		
Cash and investments	7 577	5 827
Superannuation assets	4 916	3 996
Physical assets	20 817	22 825
Other	3 587	2 555
	36 897	37 084
Liabilities		
Unfunded superannuation	3 543	3 909
Borrowings	10 870	13 243
Employee entitlements	1 024	1 028
Superannuation liabilities	5 117	3 945
Other	4 414	4 476
	24 968	26 601
Net Assets	**11 929**	**10 483**

Assets

The net assets of the Government have increased by $1.5 billion to $11.9 billion. This increase was due mainly to the book profit realised on the disposal of the government-owned electricity businesses.

The graph below shows the components of total assets and indicates that the State's financial position consists mainly of physical and infrastructure assets, particularly when considering that the cash and investments includes $1.3 billion being held from the disposal of the government-owned electricity businesses, which was used to pay off debt in 2000-01.

Total Assets as at 30 June 2000

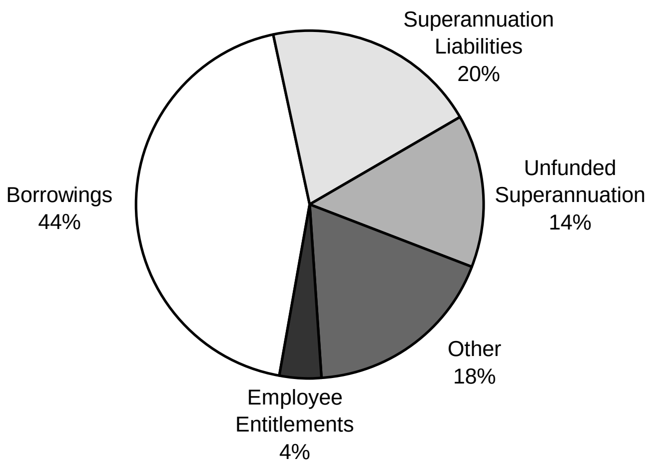


Liabilities

Total liabilities decreased by $1.6 billion as a result of increased debt retirement using the proceeds received from the disposal of the State's electricity businesses. This decrease in borrowings does not include the $1.3 billion received by the Government, but not used to physically repay debt as at 30 June 2000.

The graph below shows that borrowings and superannuation liabilities are the most significant liabilities. These make up 78 percent of the total liabilities.

Total Liabilities as at 30 June 2000



CONCLUSION

Progress continues to be made in whole-of-government financial reporting within South Australia, with the 1999-2000 financial statements being the second set of statements subject to audit review. Although limitations still exist with the current reporting process, the usefulness and importance of these reports in providing an understanding of the broad structure of the State's financial position is recognised as a key reporting tool of the Government. This usefulness would be significantly improved, however, by the more timely completion of the Financial Statements.

GOVERNMENT MANAGEMENT AND BUDGET REFORMS

BACKGROUND

For a number of years I have reported on government reforms that were originally referred to as the Government Management Framework (GMF).

The objective of those reforms was to:

- improve the focus, competitiveness, responsiveness and accountability of public sector operations;
- ensure that the Government's strategic priorities drive agency planning, operations and budgeting;
- improve the strategic management of government and agencies;
- ensure that the public sector plans, allocates, monitors and accounts for resources in terms of what it intends to achieve for the community (outcomes) and the services (outputs) it will provide.

In last year's Report it was recognised that the GMF Project Board, which had primary responsibility for progressing the aims of the GMF, had ceased to exist, and that ownership of the framework had been transferred to the Government's Senior Management Council and central agencies, in particular the Department of the Premier and Cabinet (DPC) and the Department of Treasury and Finance (DTF).

In my opinion, it would be fair to say that the GMF as a formal framework is now not part of the current vocabulary in public sector management.

The initial reform objectives have, however, provided a framework within which considerable management and administrative initiatives have taken place. Not all of the concepts envisaged by the GMF appear to have been implemented, or they have taken longer to implement in full than originally anticipated. This situation may have arisen from the high targets set at the commencement of the reform process, or from the management of the implementation itself.

It is recognised that a number of initiatives and principles arising from the GMF are still continuing to be pursued.

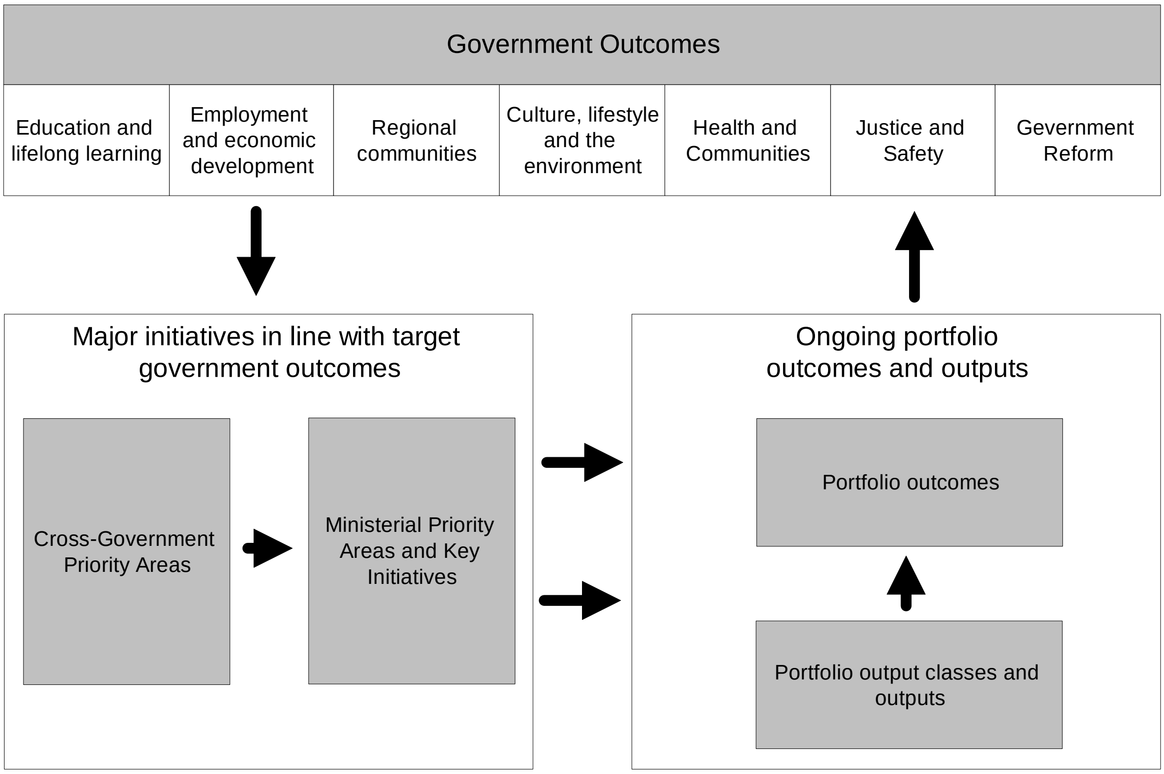
Budget Reform

In particular, activity continues on the ongoing implementation of the budget reform process. The aim of the budget reform process was stated as helping the Government deliver, through better information for decision-making, and clearer managerial authority and accountability:

- improved services;
- value for money;
- sound State finances.

As a result, considerable effort has gone into the budget reforms to develop a process whereby the budget is developed within a proper planning framework that sees that planning ‘drives the budget’.

An overview of the Government’s budget planning framework that has been adopted can be found in the introduction to the Portfolio Statements forming part of the Budget Papers and is represented as follows:



This framework identifies a number of elements in the planning process, including;

- government outcomes — the target outcomes for all government services;
- priority areas and initiatives — providing a strategic plan for the budget process;
- portfolio outputs — describes the service to be provided by the portfolio;
- portfolio outcomes — the benefits that users of government services can expect.

The communication of the result of this planning process to the community is principally through the:

- ***Budget Papers*** — which focus on portfolio outputs, although do provide a high level overview of government outcomes and priority areas, and portfolio outcomes;
- ***Directions for SA*** — which provides a general discussion of each government outcome, and the associated foundations and directions.

The focus of this section of the Report is to make a number of observations regarding the status of the budget reforms, particularly having regard to the ideals of the GMF from which they were originated. In doing so the commentary identifies a number of outstanding issues relating to:

- outcomes;
- outputs;
- financial reporting.

AUDIT OBSERVATIONS

Outcomes

Timely Communication of Government Outcomes and Key Priority Areas and Initiatives

One of the key objectives of the reform process was to ensure that the Government's strategic priorities drive agency planning, operations and budgeting. There is clear evidence that there are formal mechanisms that document this, including the internally prepared 'Ministerial Priority Outcomes' (the Green Book) and the published 'Directions for SA' document.

The Government's budget papers recognise government outcomes as '… the highest level objectives for each service provided by a portfolio'. As a result:

> *The Directions for South Australia process is the Government's key planning and priority-setting tool and provides a detailed discussion of each outcome, and the associated foundations and directions.*[55]

The Budget Papers go on to provide a highly summarised list of government outcomes and major government initiatives and priorities that formed the basis of the Budget Papers.

Although the 'Directions for South Australia 2001-02' was planned for release in June 2001, it was not released until September 2001, some four months after the presentation of the Budget Papers.

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[55] Portfolio Statements, 2001-2002 Budget Paper 5, Volume 1 Introduction.

Given that the document represents the basis on which the Budget is prepared, I am of the view that the strategic planning document should be released as part of the budget process to communicate the foundations on which the Budget was based.

In response the Department of the Premier and Cabinet indicated that:

> *The actual timing of release of the directions publication is for government to decide and it will do so based on its own view of the optimal release date. Indeed it is arguable that a later release date as occurred this year represents the most favourable communication strategy. Releasing the publication at the same time as the budget papers risks the detail contained in the publication being lost in the intense media interest which inevitably surrounds the release of the budget but tends to focus on a small number of issues.*

Whilst Audit accepts this view in relation to the release of the formal Directions for SA document, consideration may need to be given to the level of disclosure of detail for government outcomes in the Budget Papers themselves.

Measurement of Outcomes

Previous Reports have highlighted that I consider Ministerial accountability to Parliament as a fundamental element to assessing the achievement of strategic priority outcomes. Further, measurement of outcomes, to the extent it could be practically and effectively achieved, could enhance the accountability of Executive Government to the Parliament and this matter needed to be monitored for progress in ensuing years.

In the absence of effective, external performance measurement, the current model for budget formulation and measurement does not, in my opinion, provide the improvement in accountability that was envisaged in the original GMF objectives. Further, I have previously drawn some parallels between Budget Reform and its predecessor Program Performance Budgeting (PPB) in the context that PPB never reached the expectations that were envisaged for its use as an accountability and performance monitoring mechanism, reinforcing the need for performance measurement.

In 1999-2000, the DTF advised that Cabinet had agreed that portfolio outcome measures would not be prepared in the 2000-01 Portfolio Statements. However, DTF suggested that this decision reflected only a current inability to pursue such measures rather than a decision not to pursue the objective.

The decision made not to pursue, for the 2000-01 Budget, the measurement of outcomes, in Audit's view created uncertainty as to the validity of the overall reformed budget process. That is, the effective link between outputs and outcomes would not form part of the accountability chain for measuring the extent to which agencies have satisfied community objectives as reflected in the Budget Papers.

Following consideration in 2000-01 of how to progress an outcome framework, DTF concluded that:

> *… in the immediate term … it would be appropriate to focus upon improving the clarity and relevance of the outputs and measures reported by portfolios rather than seeking to develop an outcomes measurement model for South Australia.*[56]

Whilst agreeing with the DTF on the need to continue this focus on outputs, it is, in my view, appropriate to continue to advance, at least at a strategic level, the push for improvements in outcome measurements.

In making this comment, it is recognised that the development of outcome measures is not a simple task, and one that has been deferred by a number of the other States. In addition, it may be that appropriate outcome measures can not be identified for all objectives, but the process alone may provide considerable benefits in terms of a better understanding of outcomes.

Therefore, the development and measurement of outcomes is a process that in my view, should be pursued in order to continue the momentum of focusing on what governments and agencies are trying to achieve, and enhancing accountability for what is achieved.

Outputs

Key Performance Indicators (KPIs)

A significant part of the budget reform process was the recognition of outputs, and the development of key performance indicators (KPIs) that demonstrated an agency's success or otherwise in achieving those outputs.

Output KPIs were first developed for the 1999-2000 budget and were in their formative stages, with a view to refining them in future years. It was anticipated that significant work would be undertaken in further refining the KPIs and making them a core management philosophy throughout agencies. The main areas that had required further work, as noted in my 1999 Report, were:

- the robustness of output KPIs and how well they address the qualitative criteria of relevance, focus, clarity, auditability (reliability) and decision-usefulness;
- to what extent the culture of performance orientation has permeated agencies' internal management practices;

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[56] Cabinet submission, May 2001, Portfolio Statements for the 2001-02 Budget

- the finalisation of the performance management model, encompassing performance reporting, validation, use of performance information in the budget process, etc.

Although some improvements had been made during 1999-2000, I reported last year that significant gaps still remained. Although considerable work continued to occur during 2000-01 to enhance output measures, there are a number of issues that I believe remain outstanding.

Continuous Improvement of Output Measures

The non-financial nature of most output measures are such that they are often difficult to identify and measure. As a result it is expected that they would take some time to develop and refine to the stage where they provide an accurate picture of the achievement of the desired output.

During the year the DTF commenced a review of outputs and measures reported in Portfolio Statements across the public sector. In particular, the DTF began working with two agencies on improving their outputs and measures, with the plan to work with other portfolios during the 2001-02 financial year. Audit was advised that the aims of the review included the attempt to resolve the following issues in relation to outputs:

- consistency with agency internal reporting;
- comprehensive coverage of output recognition and measurement;
- data integrity issues.

Although it could be argued that the scope of such reviews is more properly undertaken by agencies themselves, in my view, given the integration of outputs into the budget process, and the need to ensure their consistency across agencies, there needs to be continued coordination and leadership by the DTF to ensure ongoing improvement in this area of budget reform.

As a result, Audit will continue to monitor the effort of the DTF to improve output measures across government.

Accountability for Output Performance

The output KPIs prepared as part of the budget process are reported in the Portfolio Statements that form part of the 2001-02 Budget Papers. The Portfolio Statements are seen as a key element of the accrual-output budgeting approach as they outline financial and non-financial information about the services provided to and on behalf of the community by each portfolio.

The information in the Portfolio Statements with respect to output indicators includes the estimated year end result (as the Budget Papers are tabled in Parliament in May), together with the target result for the following year.

While this level of disclosure may be appropriate in the context of the budget documents, accountability of agencies for outputs is not being achieved because:

- there is no requirement for the publishing of results against budgets for the same period;
- actual outputs (as opposed to estimated) are not required to be published.

The absence of the requirement to report on these matters is, in my view, inconsistent with the aims of the reform process, the objectives of which included improving the accountability of public sector operations, and ensuring the public sector accounts for resources in terms of the services it provides.

I therefore recommend that consideration should be given to developing a reporting regime for output measures. Such a regime could be implemented, for example, through a requirement for such information to be included in agency annual reports, or by a reporting mechanism in the format of the Budget Portfolio Statements following the completion of the financial year.

Internal Reporting of Output Performance

As discussed above, there is no requirement for agencies to publicly report on their achievements against the identified output measures.

Notwithstanding this, actual results against output measures were reported by agencies to the DTF in October 2000 and were compared to the targets included in the previous year's Budget Papers. These were then collated and provided to Cabinet for noting in December 2000.

Whilst it is pleasing to note that internal reporting of the measures was in place, in my view, there is scope to further enhance the process by:

- identifying performance indicators that can and should be measured and reported on a more regular basis;
- working to improve the time between the reporting period, and when they are reported.

Further improvement to the current process would, in my view, improve accountability and further encourage the use of the indicators in the ongoing management of agencies.

Financial Reporting

In last year's Report I noted that 'there is no basis for frequent reporting in a monitoring sense to Cabinet on a current year's budget — financial (recurrent and capital) and non-financial — the focus seems to be on updates for the next budget cycle'.

It should be recognised that putting in place a comprehensive reporting arrangement for such a large and diverse organisation (ie the whole-of-government) is not a simple task, but one which is still important if those charged with responsibility for managing it are to be provided with information necessary for decision making.

During the 2000-01 year progress was made by the DTF towards monthly whole-of-government financial reporting, however, it is evident that there is still considerable work to do to improve on that progress. In particular, Audit noted that there was a need to improve the:

- process for the collection and consolidation of data;
- quality of data, as considerable work is required to be undertaken on initial information supplied by agencies;
- timeliness of reporting the information generated, as it was taking approximately 10 weeks to prepare monthly reports;
- reporting regime, as reports are currently only provided to the Treasurer.

Given the complexity of the task and the need for the improvements identified, there needs to be, in my view, continued coordination and leadership by the DTF to ensure that relevant, accurate and timely information is available to Executive Government to allow it to monitor government finances.

Also, with respect to the process for the collection and consolidation of data, it is noted that the contract review for the mandated whole-of-government financial system was recently delayed for approximately three years. It will be important that the management of the project to review this contract is properly planned and scoped, as it is likely to be critical in the context of ongoing management reporting improvements at the government wide level.

CONCLUSION

Although the Government Management Framework has ceased to exist in a formal sense, the implementation of reforms arising out of it continues. In particular, although substantively in place, budget and financial reforms are continuing to be completed and/or refined.

A review by Audit of the status of reforms has identified the need for continued work in a number of areas, namely:

- the more timely communication of government outcomes and key priority areas and initiatives to support the detailed Budget Papers;
- the need to progress, at least at a strategic level, the issue of measuring outcomes;

- continued coordination and leadership by the DTF to ensure ongoing improvements in agency output measures;
- the development of a reporting regime that provides greater accountability for agency outputs;
- improved timing and regularity of internal reporting of output measures;
- continued coordination and leadership by the DTF to ensure ongoing improvements in the quality and timeliness of whole-of-government reporting to Executive Government.

NATIONAL COMPETITION POLICY IMPLEMENTATION ARRANGEMENTS: AUDIT OBSERVATIONS AND COMMENTS

INTRODUCTION

In 1992, the Council of Australian Governments (which comprises all nine governments, ie State, Territory and Federal) commissioned an inquiry into National Competition Policy (NCP).

Acting on the recommendations of that inquiry, a number of reforms were drawn together in 1995 to form a package, agreed upon by all Australian Governments, and called National Competition Policy.

National Competition Policy contained a number of reforms designed to enable and encourage competition, including:

- the extension of 'Trade Practices' laws to all businesses, including those that are government owned;
- the introduction of 'competitive neutrality' so that privately-owned businesses can compete with those owned by government on an equal footing;
- the review and reform of all laws that restrict competition unless the benefits of the restriction outweigh the costs and the objectives of legislation cannot be met except by restricting competition;
- the development of a 'National Access Regime' to enable competing businesses to use nationally significant infrastructure (like airports, electricity cables, gas pipelines and railway lines);
- specific regulatory reforms to the gas, electricity, water and road transport industries.

This section of my Report focuses on the status of implementation of these reforms, and the impact that this will have on the receipt of NCP payments.

NCP Payments

The economic benefits of NCP reforms were expected to accrue mainly to the Commonwealth Government through increased income and business taxation revenue as a result of greater economic activity flows. To compensate the States and Territories, which are responsible for the costs of these NCP reforms, the Commonwealth Government agreed to make additional general-purpose payments (GPPs) provided that satisfactory progress was made in implementing NCP. Where satisfactory progress was not made, penalties may be imposed by the Federal Treasurer through States/Territories not receiving the full estimated amount.

The estimated amount of future payments that are still available to South Australia, based upon the completion of reform obligations, are as follows:

Year	Amount $'million
2001-02	55.3
2002-03	56.4
2003-04	57.3
2004-05	58.6
2005-06	59.8

Source: Commonwealth Treasury (as at July 2000)

In addition, in November 2000, it was announced that annual competition payments would be on going beyond 2005-06.

Governments, to date, have been formally assessed on their reform progress every two years since 1997, with the National Competition Council's (NCC's) assessment forming the basis for the Federal Treasurer's decision on NCP Payments.

The third tranche assessment was to be the last, however, due to the complexity and enormity of reforms required, some reforms have had their timetables extended beyond 2001. These include the following:

- rural water reforms (will not be completed until at least 2005);
- the national electricity market (will not be fully implemented for several years);
- remaining road transport reforms;
- completion of the legislation review (the deadline is now set for mid — 2002).

As a result of these extensions, governments agreed that the NCC would conduct annual assessments at least up until 2005. The next NCC assessment is therefore scheduled to occur in June 2002.

THIRD TRANCHE ASSESSMENT FRAMEWORK

As mentioned above, receipt by the State and Territory Governments of NCP payments from the Commonwealth Government, is dependent upon the achievement of certain reforms, as specified under the Third Tranche Assessment Framework. For the third tranche these achievements included:

- whether the State or Territory has remained a fully participating jurisdiction as defined in the Competition Policy Reform Bill;

- the extent to which each State or Territory has complied with the competition policy principles in the Competition Principles Agreement (including the review of legislation that restricts competition);

- continued effective observance of reforms in electricity, gas, water and road transport;

- the setting of national standards in accordance with the Principles and Guidelines for National Standard Setting and Regulatory Action and advice from the Office of Regulation Review on compliance with these principles and guidelines.[57]

The third tranche assessment was to be a comprehensive appraisal of the completion of the reform process, however, as a result of the extensions granted, this assessment was based on progress similar to the first two assessments already conducted.

THIRD TRANCHE ASSESSMENT

Report Submitted by South Australia

In accordance with the Competition Principles Agreement, South Australia submitted a report to the NCC in March 2001 discussing the progress that the State was making in terms of satisfying all NCP obligations and reforms.

The submission indicated the implementation of the following principles and reforms:

- the implementation of competitive neutrality has been undertaken progressively and is now substantially complete;

- pricing reforms have progressed to now satisfy second tranche obligations, including the establishment of the SA Independent Industry Regulator;

- structural reforms within Government Business Enterprises have been well progressed towards finalisation, with the exception of continuing changes to TAFE Institutes;

- solid progress was made in 2000 in reviewing legislation containing restrictions on competition.

The report also submitted that South Australia had made solid advancement in the areas of electricity, gas, water and road transport in relation to implementing a number of Council of Australian Government (COAG) agreed frameworks and reforms.

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[57] Attachment to Agreement to implement the NCP and Related Reforms.

NCC Third Tranche Assessment

A draft of the NCC assessment of South Australia's submission was received by the Government in June 2001. Audit understands from discussions with officers from the Department of the Premier and Cabinet, that the assessments do not contain any penalties for South Australia (ie all NCP payments will be received by South Australia). Notwithstanding this, there were a number of areas set out by the NCC that the State needs to address in order to prevent penalties being incurred in future years. In summary the areas requiring further progress include:

- legislation reviews, particularly relating to taxi licensing, shop trading hours, barley, workers compensation and gambling;
- the need to implement a more transparent approach to water price regulation and addressing the issue of independent prices oversight;
- the introduction of full retail competition for January 2003 for the electricity sector.

Audit understands that South Australian Government agencies are currently working with the NCC to resolve and, where needed, clarify the above issues.

Where the State decided to retain legislative provisions with restrictions on competition, or not implement recommendations made by the legislation review, the State Government is required to make public the 'public interest case' justifying this decision. This includes disclosure of costs resulting from adjusting to the change and the likely impact on specific industry sectors and communities.

CONCLUSION

Audit has been advised that there are no matters arising out of the recent assessment of South Australia's compliance with the Competition Agreements that put at risk competition payments to the State in the short term. There is, however, still work expected of the State to complete the reform program, which will be assessed by the NCC on an annual basis in the future.

ASSET DISPOSALS

INTRODUCTION

2000-01 saw the completion of the disposal of the State's electricity assets and announcements on progress with other asset disposals that are most significant to the Government's overall debt and risk reduction strategy.

This section of the Report provides an update on the program of asset disposals commenced by the Government including:

- an overview of the principal parties responsible for the current asset reform and disposals program;
- a commentary on the current asset disposals process and summaries of specific assets.

RESPONSIBILITY FOR ASSET REFORM AND DISPOSALS

In February 1998, the Government announced its asset sales agenda, stating that ETSA Corporation and SA Generation Corporation (trading as Optima Energy) were to be sold and that the Government was also considering a number of other sales including: the Lotteries Commission of South Australia (Lotteries Commission); the South Australian Totalizator Agency Board (SA TAB); the South Australian Ports Corporation (Ports Corp). This Part of the Report covers the status of the above asset sales.

HomeStart Finance; WorkCover Corporation of South Australia (WorkCover); and the Motor Accident Commission (MAC) and SAGRIC International Pty Limited (SAGRIC) were also added to the list of assets being subjected to a detailed scoping study to assess commercial risks of ownership against benefits provided. The status of these assets was covered in last year's Report and all of these assets have been removed from the assets sales agenda except for SAGRIC which was sold.

Given the number, complexity and size of the asset disposals that have been implemented with one still under consideration, the majority of these disposals were coordinated through a detailed series of procedures involving a Cabinet committee, departmental committees and specific groups within Government.

The following provides an overview of the reporting relationships.

CABINET

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Asset Sales Cabinet Committee

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Asset Sales Advisory Panel and Asset Sales Steering Committee

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Departments

↑

Asset Reform/Sale Oversight Groups

Two departments have been allocated primary responsibility for distinct parts of the reform, sale/lease process, namely:

- ***Treasury and Finance: The Electricity Reform and Sales Unit*** was established by Cabinet to manage the reform, restructure and sale/lease process for the electricity entities and to advise the Treasurer of the appropriate policies, objectives and procedures with respect to the management of those assets.

- ***Administrative and Information Services: The Government Businesses Group*** was established within the Department for Administrative and Information Services and is responsible for the Department's assets sales program. Review/Project teams were established by Cabinet in a previous year and are located within the Government Businesses Group. The group remains responsible for the oversight of the review and possible sale of the other specified Government assets.

Although these parties have the responsibility for the scoping studies to determine whether a disposal is the best option for the State, the nature of their operations normally results in others being involved in the process, including the Department of Treasury and Finance, and the Crown Solicitor's Office.

COMMENTARY ON ASSET DISPOSALS

Department of Treasury and Finance — Electricity Reform and Sales Unit (ERSU)

The disposal of the State's electricity assets was completed during 2000-01. With the completion of the disposal of the State's electricity assets, the Electricity Reform and Sales Unit (ERSU), was disbanded from 1 January 2001. Electricity reform management is now part of the broader microeconomic reform function in the Department of Treasury and Finance and is funded from revenue from government.

I had responsibilities in relation to reporting, on the long-term leases for electricity assets; on the proportion of proceeds used to retire State debt; on the amount of interest on State debt saved as a result of the application of those proceeds; and on the probity of the processes leading up to the making of each long-term lease. These matters were reported separately to Parliament in a series of reports. The final Report was tabled on 20 March 2001 and was titled 'Electricity Businesses Disposal Process in South Australia: Report by the Auditor-General Pursuant to section 22(2) of the *Electricity Corporations (Restructuring and Disposal) Act 1999* on Relevant Long Term Leases'.

Department for Administrative and Information Services (DAIS)

The Disposal Process

As mentioned above, the Department for Administrative and Information Services is responsible for the possible sale of the other specified Government assets. The Government Businesses Group (GBG) of the Department has prime responsibility for the management of the review, reform, and possible sale of those assets. It is assisted by Review/Project Teams that have been established and located within the GBG.

In conducting asset sales for which it is responsible, the Department follows the same disposal process as the ERSU did. This process involves three stages, namely Scoping Review, Sale Preparation and Sale Implementation.

The overall sales process requires Cabinet decisions at the end of each stage, before progressing to the next stage.

Status of Asset Disposals

Lotteries Commission of South Australia

Following the submission of a scoping review, Cabinet in September 1999, reaffirmed its decision to sell the Lotteries Commission. In February 2000, the Government announced its intention to offer for sale the operations of the Lotteries Commission.

In June 2000, a Parliamentary Bill to allow for the disposal of the Lotteries Commission, titled 'Lotteries Commission (Disposal) Bill 2000' and a consequential Bill to provide for the licensing and regulation of the conduct of lotteries, titled 'Authorised Lotteries Bill 2000' were introduced into Parliament. In November 2000, the two Bills were defeated on a motion not to proceed further with the Bills. Subsequently, the Lotteries Commission has been taken out of the Government's asset sales agenda. It has been indicated that the Government will move to corporatise the Lotteries Commission, which will retain the asset in Government hands, but will go some way towards reducing the risk to the taxpayer.

As mentioned above, the Asset Sales Unit (Gaming) within DAIS was managing/coordinating the possible sale of the Lotteries Commission with much of the technical work being undertaken by consultants.

Total consultancy expenditure for the period 1 July 1997 to 30 June 2001 inclusive was $1.5 million, of which $0.4 million was incurred during 2000-01.

As a consequence of the Lotteries Commission being removed from the Government's asset sales agenda, expenditure on consultants ceased during the 2000-01 financial year.

SA TAB

Following progressive submissions of the scoping review on the sale, in September 1999, Cabinet confirmed its decision to sell the SA TAB. In February 2000, the Government announced in principle its decision to sell the SA TAB.

In June 2000, legislation to allow for the disposal of the SA TAB was introduced into Parliament. The legislation comprised; an Act for the disposal of the SA TAB, titled '*TAB (Disposal) Act 2000*' and a companion Act to provide for a new regulatory regime in the context of the sale of the SA TAB, titled '*Authorised Betting Operations Act 2000*'. The two Acts were assented to in December 2000. The *TAB (Disposal) Act 2000*, amongst other things, requires the Minister to have a Report on the probity of the processes leading up to the making of a sale agreement prepared by an independent person engaged for the purpose and for that Report to be laid before Parliament within a specific timeframe.

Throughout the sale process, Audit has consulted with the Asset Sales Unit (Gaming) and the Independent Probity Auditor in respect to processes and procedures that were proposed to be followed by the Asset Sales Unit (Gaming).

As mentioned above, the Asset Sales Unit (Gaming) within DAIS is managing/coordinating the sale of the SA TAB with consultants conducting much of the technical work for the sale.

Expenditure on consultants for the period 1 July 1997 to 30 June 2001 inclusive was $5.8 million, of which $3.7 million was incurred during 2000-01.

In August 2001, Cabinet approved and the Government announced in its media release that the SA TAB was sold to TAB Queensland Limited for an amount of $43.5 million. The final settlement of the sale is expected to take effect in January 2002, subject to probity checks by the Gaming Supervisory Authority.

Cabinet's approval of the sale in August 2001 has coincided with the preparation of this Report to Parliament. As a consequence, Audit has not been able to finalise its review of the disposal process, the agreements executed for the sale and the accountability of the sale proceeds.

Any issues arising from the review, will be the subject of comment in a Supplementary Audit Report.

South Australian Ports Corporation

Following the submission of a scoping review, in March 1999, Cabinet approved the sale of the South Australian Ports Corporation (Ports Corp) by way of a trade sale. In April 1999, the Government announced its intention to proceed in principle with the divestment of the Ports Corp. The Ports Corp Sale Project Team within DAIS has continued to manage the review and disposal process.

In November 1999 the Government announced that the Kangaroo Island ports, including Kingscote, Penneshaw and Cape Jervis would not be included in the disposal, as these ports '… are community ferry ports and are quite different from the larger commercial wharves that operate elsewhere in the State'. Navigational aids, channels and breakwaters have also been excluded from the proposed divestment of the Ports Corp.

The legislation enabling the divestment of the Corporation, the *South Australian Ports (Disposal of Maritime Assets) Act 2000*, was proclaimed in January 2001. Essentially this legislation facilitates the divestment of the Corporation's assets and liabilities. It includes specific provisions governing the disposal of maritime assets or liabilities by way of a sale/lease agreement, the terms of certain sale/lease agreements and requires transfer orders or sale/lease agreements to be laid before both Houses of Parliament together with a Report on the probity of the divestment process. For this purpose, the Minister for Government Enterprises engaged the services of a legal firm to provide probity auditing services relating to the divestment process.

In March 2001, the Government sought public offers for the divestment of Ports Corp through a tender process. Expressions of interest were received in April 2001 with final bids being received on 9 July 2001.

As mentioned, the Ports Corp Sale Project Team within DAIS is managing/coordinating the divestment of the Ports Corp with consultants conducting much of the technical work for the divestment process.

Total consultancy expenditure for the period 1 July 1997 to 30 June 2001 inclusive was $3.8 million, of which $2.2 million was incurred during 2000-01.

As at the date of preparation of this Report, no announcement had been made with respect to the results of the divestment process. Audit will continue to monitor developments associated with the divestment.

CONCLUSION

Electricity Assets

The completion of the sale/lease of the electricity entities means that a major feature of the Government's budget and debt reduction strategy has been achieved.

As mentioned previously, I had responsibilities to report on the disposal of electricity assets and a series of reports associated with the disposal process were tabled in Parliament. The final Report was tabled on 20 March 2001 and was titled ‘Electricity Businesses Disposal Process in South Australia: Report by the Auditor-General Pursuant to section 22(2) of the *Electricity Corporations (Restructuring and Disposal) Act 1999* on Relevant Long Term Leases’.

Other Asset Disposals

The finalisation of the sale of the SA TAB and the decision to be taken on the successful bidder for the SA Ports Corporation are not so much a feature of the Government’s budget and debt reduction strategy but are a feature of the Government’s business risk reduction strategy.

There is a need for the disposals to be underpinned by sound processes that exhibit transparency and reflect appropriate accountability mechanisms. It is essential that, in the event of disposal, maximum benefit is achieved by the disposal process in terms of disposal proceeds as against the revenue forgone and risk which has been mitigated.

Audit will continue to monitor the progress of asset disposals, review procedures and financial analysis justifying the decisions taken to accept final bids and ensure that proceeds are used for the purpose for which they are intended. Any issues arising from a review of the sale processes will be the subject of comment in a Supplementary Audit Report.

PUBLIC SECTOR WIDE ISSUES:

SPECIFIC AUDIT ISSUES AND

MATTERS OF IMPORTANCE AND INTEREST

CONTRACTING DEVELOPMENTS: IMPORTANT POLICY, MANAGEMENT AND CONTROL ISSUES: AUDIT COMMENT

INTRODUCTION

Significant developments relating to government contracts have been initiated or progressed by the Government and its agencies during the 1990's and in recent times.

My Reports over the past years have included frequent and varied commentary concerning these developments and have commented on important matters of governance, financial management and accountability. Matters discussed have covered commercial/public interest confidentiality, accountability, risk and liability exposure and project and contract management (including the exercise of due diligence and the monitoring of performance and contract obligations).

Contractual arrangements traverse a broad spectrum. They include building construction, asset sales or leasing, information technology, industry incentives, management and service delivery outsourcing and major events. Many of the developments are characterised by complex contract administrative arrangements with private sector entities for project and service delivery outcomes.

During 2000-01 the Government released a new policy on disclosure of government contracts that will have important accountability effect from the commencement of the 2001-02 financial year. Audit has also in 2000-01 continued to review matters associated with government projects and the related contractual arrangements.

This section of the Report discusses salient features of the Government's new policy release and comments on some matters of note arising from this year's review of certain project and contracting arrangements. There is also specific comment at the end of the section regarding state and audit access arrangements under contract arrangements with private sector entities.

NEW GOVERNMENT POLICY FOR CONTRACT DISCLOSURE

Previous Audit Comment

My 1997-98 Annual Report provided comment on a number of specific matters concerning government contracting (Audit Overview: Part A.3: Government Contracts).

One such matter discussed covered the issue of commercial confidentiality and/or public interest confidentiality. I stated that, in assessing claims for confidentiality in respect of government contracting, in my opinion, the operative principles are:

- the right of the people to know;

- the accountability of Parliament to the people;
- the responsibility of the Executive Branch of Government to the Parliament;
- the rights of individuals or groups to assert confidentiality claims.

In stating these principles it was considered that they define a chain of accountability that underpins our system of responsible government.

My concluding comments on this specific matter included a recommendation that a review be undertaken to determine the adequacy of procedures being adopted for the treatment of confidential information for government contracts.

The new policy for contract disclosure released by the Government in May 2001 is a positive development and represents a significant accountability improvement.

Features of the New Policy

The policy 'A New Dimension in Contracting with the South Australian Government' seeks to increase accountability for, and improve transparency of, the Government's contracting activities.

All public authorities (as defined in the *State Supply Act 1985*) come within the ambit of the requirements of the policy.

The type of contracts to which the policy will apply include general goods, services and works; asset sales; consultancies; private infrastructure initiatives; industry assistance; major events and grants; and public sector executive contracts.

In general terms the Government's policy means that government contracts will be made publicly available in full or in summary form.

There are some exemptions from the policy based on the type and size of the contract. Additionally, the policy does not require disclosure in the cases of genuinely confidential business information, trade secrets and intellectual property, defence, national security, public safety or government building security information, public interest and legal risk.

The policy will be effective in relation to contracts formally entered into from 1 July 2001. However, the Government is also establishing a process through the Prudential Management Group to negotiate the disclosure of contracts entered into since December 1993 which have a value of $4 million or more.

The policy is also designed to complement the Government's 'Purchasing Strategically' policy framework developed for the implementation of procurement reform. The next section of this Part of the Report discusses important developments concerning the Government's procurement reform strategy.

AUDIT COMMENT ON PARTICULAR PROJECT AND THE RELATED CONTRACTUAL ARRANGEMENTS

The commentary that follows refers to some matters of note arising from audit reviews during the year. They relate to change, performance accountability and contract issues associated with certain major projects and contract arrangements.

The matters and issues emphasise the importance of government and its agencies and officers, to exercise diligence and appropriate project management skill and process in the initiation, execution and delivery phases of project/contract arrangements. In addition, where the delivery phase involves ongoing service delivery obligations over an extended duration, the application of a quality contract administration process is essential.

The application of these attributes can reduce the risks of not meeting project/contract predicted benefits/outcomes, including avoidance of unexpected costs and potential liabilities.

Adelaide Convention Centre Project Extension

In May 1999 Cabinet approved an $85 million extension for the Adelaide Convention Centre. In October 1999 the Public Works Committee issued its Report in relation to the extension project, which recommended that the project proceed. The project, due for completion in September 2001, is to provide an additional 7 000 square metres of exhibition space (creating a total exhibition area of more than 10 000 square metres) together with banquet facilities for up to 4 800 people.

On 20 August 2001 Cabinet approved a submission from the Minister for Tourism and the Premier for an additional appropriation of up to $7.4 million and expenditure approval up to a limit of $92.4 million in relation to this project. This approval was subject to the final appropriation amount being agreed between the Premier, the Treasurer, Minister for Tourism and the Minister for Administrative and Information Services. Cabinet was also advised that a formal recommendation for final project funding and expenditure approval will be submitted to Cabinet after completion of construction and reconciliation of all outstanding contractor and consultant claims.

To minimise the risks to the project in terms of cost, and meeting the completion date, a separate agreement (Acceleration Agreement) was initiated with the managing contractor in July 2001. This agreement included provision for settlement of potential claims from the managing contractor and specific authorisation and incentive to the managing contractor to prudently manage cost claims and additional resource costs relating to achieving acceleration of the works. The Acceleration Agreement does not cap the risk of subcontractor cost claims for additional variation work. The abovementioned revised project expenditure approval limit of $92.4 million takes into account the implementation of the Acceleration Agreement.

Further information regarding this project is provided in the section 'Department for Administrative and Information Services' in Part B of this Report.

Concluding Comment

In my opinion, the experience with respect to this matter raises issues of concern. The concept and initiation processes and the related contractual arrangements associated with this project did not ensure that the Governments objectives of costs of construction within the initial approved budget were achieved.

Audit proposes to review this matter and the operation and management of the Acceleration Agreement in 2001-02.

Glenelg/Holdfast Shores Development

Introduction

In November 1997, the Government entered into a Development Agreement with a Consortium made up of private sector entities to develop certain areas of Glenelg and West Beach in accordance with a Master Plan prepared by the Consortium. The Master Plan proposed development of the area by the Consortium, within specified timeframes, in a number of precincts. Aspects of the proposed development involved areas of residential, retail, entertainment, boating, recreation and tourism facilities at Glenelg and West Beach. The Government has responsibility for certain infrastructure works associated with the project.

The Development Agreement provided for distribution of returns to both the Consortium and the Government at completion of the overall project. In general, returns were to be dependent on profits achieved through the sale of development components, including retail and commercial aspects. The Project Master Budget (which forms part of the Agreement) assumed a return to Government of $9.66 million, which included expectations of certain levels of interest in an entertainment complex.

The Agreement has undergone variations throughout the term of the development to date. A major variation to the Agreement was executed in February 2001 following approval of Cabinet in the same month. The levels of interest in retail and entertainment aspects have not reached the levels anticipated in earlier projections. As a result, the major variation approved by Cabinet indicates the return to government is now expected to be $3.7 million. This figure could be enhanced by renewed interest in retail aspects. This level of expected return was reflected in the revised Project Master Budget forming part of the major variation agreement.

Background to the Major Project Variation

In September 2000 Cabinet considered a number of options and endorsed an approach requiring negotiation with the Consortium to establish a Major Project Variation. This event was triggered as a result of the project not achieving precinct development commencement timeframes and expected distribution of returns on the overall project. It was noted in the Cabinet Submission that in the event that the major variation could not be satisfactorily negotiated and agreed, the Government could have elected to terminate the Agreement upon completion of certain existing project works. It was further noted that the Government would then have the option of seeking new developers for aspects of the project not yet commenced, notably the Hotel and Entertainment Precincts.

In February 2001, Cabinet ratified the negotiated major variation between the Minister for Government Enterprises and the Consortium. This variation agreement provided for:

- the continuation of the Agreement with the Consortium;
- the provision of an option to the Consortium, or one or more of the Consortium members, to acquire and develop land associated with the Hotel and Entertainment precincts;
- land sale proceeds relating to the Hotel and Entertainment precincts to continue to be project revenue;
- a change in the formula for final distribution of project returns to the Government and the Consortium.

Audit Review and Approach

The 1998-99 Auditor-General's Report to Parliament included commentary regarding scope for improvement with respect to a number of administrative and reporting processes mandated by the Development Agreement.

Audit review during 2000-01 examined the status of the project development to-date and the implications of the major variation to the Development Agreement, including the effect on risk and return to the Government.

Several issues arising from the review were communicated in writing to the Chief Executive of the Department for Administrative and Information Services (DAIS) and are discussed below.

Continuance of Arrangement with the Consortium

As outlined above, in February 2001, Cabinet effectively endorsed a decision to continue the Development Agreement with the Consortium by means of ratification of the Major Project Variation. Audit understands that, alternatively, the Government could have sought other development arrangements from the market including the sale of land to a developer with proceeds solely retained by the Government.

The Major Project Variation required that the land could be sold only to an entity that included at least one of the Consortium members. Audit noted that independent and formal market analysis was not undertaken regarding other development arrangements. Further, Audit understands that the land sale values (of $3.5 million for each of the two precincts) were a result of negotiation rather than based on independent valuation.

Audit sought advice as to the consultation process regarding continuation of arrangements with the Consortium, including options considered and major factors influencing this decision making process. Audit also sought an explanation regarding the basis of reasoning for establishment of a land sale value of $3.5 million each for the Hotel and Entertainment precincts and the rationale for not obtaining independent valuation advice.

DAIS indicated in their response that the possibility of terminating the Development Agreement was considered but not recommended for a number of reasons, including:

- a desire to minimise any negative impact on the momentum of the project;
- a number of encumbrances and obligations relating to the Hotel and Entertainment Precinct sites that would have complicated a sale to another party.

With respect to the determination of a land sale value for the Hotel and Entertainment Precincts DAIS indicated that a number of matters were considered, including:

- valuations completed by independent consultants in February 1997 indicated market values of $3 million and $2.2 million respectively for the Entertainment and Hotel Precincts;
- comparison with alternative 'serviced apartment' style development;
- the Entertainment Precinct would be difficult to successfully develop;
- the negotiations were based on transferring the ongoing development risk and project costs associated with the Hotel and Entertainment Precincts from Government to the Consortium.

Monitoring of Costs

The Major Project Variation provided for a change in the formula for calculating returns to the project participants. The original formula provided for a distribution of returns based on agreed percentages. The new formula provides that a lump sum will be initially paid to the Government absolutely and any distributions remaining will be distributed according to agreed percentages.

Audit's review of predicted final distributions indicated that there was a risk that distributions may not exceed the initial payment to the Government.

As there is a change in the risk profile associated with the expected project distributions to government, Audit considered that the Government, through the Project Committee, should require formal changes to the process of monitoring project fees and expenses, as these are the main factors impacting on the risk to government.

DAIS, in their response, acknowledged that the Project Committee must continue to monitor project and operating costs of the project. DAIS also indicated that action would be taken to ensure that the Consortium is required to submit monthly financial reports, including explanations of any variances or extraordinary expenditure, for approval by the Project Committee.

Glenelg Civil Works Cost

Audit noted that there is a difference in respective interpretations between the Consortium and the Government as to whether clause 17.4 of the original Development Agreement (which provides for the Consortium to pay or fund all loses incurred in respect of the project as a whole), extends to include the Glenelg Civil Works Cost. The difference of view has been explicitly recognised in the Major Project Variation. It is noted that the Cabinet Submission recommending approval of the major variation made no reference to this matter.

Audit sought advice as to whether written expert legal advice has been received regarding the interpretation and application of Clause 17.4 in respect of the firmness of the Government's position in this matter. In addition, Audit sought advice as to whether the specific nature of this matter and its implications had at any stage been referred to Cabinet.

DAIS responded that independent legal advice indicated that if the Glenelg Civil Works Costs and other project costs are not fully reimbursed from the revenue of the project then the Consortium is liable to pay the shortfall pursuant to Clause 17.4. In view of this advice, the fact that the Major Project Variation Master Budget does not forecast a total loss, and that the Major Project Variation does not alter Clause 17.4, this matter was not specifically referred to Cabinet.

Concluding Comment

In my opinion, it is imperative that enhanced contract management arrangements be implemented to monitor the ongoing project fees and expenses to minimise any further diminution in the return to Government.

Schlumberger Agreement

Background

Since 1995 significant water industry contracts have been entered into by the Government. While audit coverage during the year was directed to all the contracts, primary focus was directed to the review of the administration of the Schlumberger Agreement.

The South Australian Water Corporation (the Corporation) and the Minister for Government Enterprises (the Minister) entered into an agreement with Schlumberger Measurement and Systems Pty Ltd (the Contractor) in July 1998 (the Agreement).

The primary objectives of the Agreement were to facilitate the:

- supply (to the Corporation) of state-of-the art water meters at a competitive price;
- establishment of a viable and export-orientated metering industry within South Australia, that could compete effectively both in Australia and the wider Asia-Pacific region.

The Agreement also provides for economic development commitments by the Contractor in addition to the obligations to manufacture and supply water meters. These economic development initiatives were a key consideration in the selection of the preferred contractor.

As mentioned Audit conducted a review of the Corporation's overall administration of the Agreement, covering both the 'operations' and 'economic' development components of the Agreement.

Audit Review Outcome and Comment

The Agreement provides a complex set of interrelationships and obligations.

Audit identified that there was no formal contract management framework to monitor the 'operations' component of the Agreement; ie relating to the supply and manufacture of meters. Other matters identified included issues associated with economic development commitments and performance measurement.

Overall, Audit concluded that there was non-performance of contract obligations (evidenced by the requirement for the contractor to alternatively source meter bodies in response to the Contractor's inability to meet specified targets of supply quality), and a failure to validate any achieved export targets and other measures of economic development.

Further, comment concerning the issues arising from Audit's review and the Corporation's response is provided under the section 'South Australian Water Corporation' in Part B of this Report.

Concluding Comment

The management of this contractual relationship also raises issues of concern. The processes associated with contract administration have been inadequate to ensure the achievement of contractual objectives.

EDS IT Infrastructure Contract Management

Last year's Report indicated that the Department for Administrative and Information Services had two reviews of specific aspects of the EDS contract arrangement underway. These important reviews were finalised during 2000-01.

The EDS billing System review gave rise to certain issues that prevented a firm conclusion being reached regarding mainframe billing calculations perform by EDS. The Market Price review which assess EDS charges for certain agency services in consideration of market price availability resulted in a positive material gain to the State (in the order of millions of dollars).

Further commentary regarding these reviews is contained in the section 'Department for Administrative and Information Services' in Part B of this Report.

Vehicle Fleet Leasing Arrangement

The Government entered into a sale and leaseback facility in May 1996. The main benefit from entering into the facility was the anticipated achievement of a lower cost of funding of the Government's vehicle fleet.

Past Reports have communicated the importance of exercising proper management over the ongoing arrangements due to the long-term nature of the lease facility and its expected benefits over the extended period of time. This required an ongoing analysis of the elements affecting motor vehicle lease rate calculations to enable a proper assessment of the potential impact on the cost of the leaseback facility to the Government and ultimately expected benefits to be derived. The elements requiring consideration include changes in residual values of vehicles; changes in taxation law; and the number of replacement vehicle leases.

In the latter part of 1999-2000 the Department of Treasury and Finance (DTF) initiated a review of the facility to determine whether it remains economic, particular in light of the changes to the taxation system. Audit inquiry in early August 2001 indicated that this review is yet to be finalised.

DTF received in the latter part of 2000-01 a report from an external finance agency, which had been engaged by DTF to assist its review process. Audit has been advised that DTF is presently evaluating a range of options, involving further inquiry and consideration of matters with both the authors of the report and one of the leasing facility participants. DTF has not indicated a time for completion of the evaluation process but has advised of their intention to formulate a position to the Treasurer/Cabinet once the evaluation process is finalised.

Concluding Comment

In my opinion, this review should be finalised as soon as possible and a report presented to this Government.

Supply SA Warehouse Operations

Background

In June 1999 the warehouse operations of Supply SA was outsourced to a private sector entity (the Contractor).

Audit reviewed the contract arrangements in 1999-2000 and a follow up review was conducted in 2000-01. Last year’s Report included comment on a number of significant matters with respect to the contractual arrangements, stock management control and information systems arrangements.

While the Department for Administrative and Information Services in 2000-01 has managed to address various issues, the follow up audit identified matters that still warranted careful and prompt attention.

Audit Review Issues

The matters arising from the audit review are briefly summarised as follows:

- inadequate attention to establishment of benchmarks to control costs giving rise to a dispute over contract expenditure;
- operating outside contract conditions;
- contract management, including the monitoring process over contract conditions was poor;
- stock management required enhancement in certain areas.

The matters were raised with the Department and a positive response received.

More detailed commentary regarding this contracting arrangement is included under the section ‘Department for Administrative and Information Services’ in Part B of this Report.

Concluding Comment

This is a further example where, in my opinion, contract administration was inadequate.

Major Event Contract

A risk inherent in any contract arrangement is the possibility of dispute, giving rise to contesting claims between the parties to the contract or agreement, with the potential for liability exposure. Such a circumstance has arisen during the year in relation to the staging of the Le Mans event in Adelaide.

Where the circumstance involves an entity or entities of government, the relevant entity is required to include in its financial statements appropriate note disclosure of the potential liability exposure (contingent obligation). In this case the financial statements of the South Australian Tourism Commission and the South Australian Motor Sport Board for the year ended 30 June 2001 include the appropriate note disclosures.

CONTRACTS WITH THE PRIVATE SECTOR — STATE AND AUDITOR-GENERAL ACCESS

Previous Reports have referred to the important matter of both government agency and Auditor-General rights of access to contractor's records and premises, particularly where private sector contractors are discharging public functions. Last year's Report stated that:

> *Access and audit requirements are in some cases not adequately communicated to parties involved in contracting with government, and appropriate contract arrangements to provide access and audit are not consistently addressed. Thus existing contract access and audit arrangements present a fragmented approach by some individual agencies of government. This may very well in certain instances frustrate or render ineffective the monitoring role of government agencies and inhibit the audit process and the ability of the Auditor-General to efficiently discharge responsibilities under the* Public Finance and Audit Act 1987*.*

On a similar note with respect to private sector contracts, the Auditor-General for Australia in a March 2001 speech to the CPA Australia National Public Sector Convention stated that:

> *For accountability measures to be effective, it is critical that agencies closely examine the nature and level of information to be supplied under the contract and the authority to access contractors' records and premises as necessary to monitor adequately the performance of the contract. The inclusion of access provisions within the contract for performance and financial auditing is particularly important in maintaining the thread of accountability with Commonwealth agencies' growing reliance on partnering with the private sector and on contractors' quality assurance systems.*

Referral of Matter to the Prudential Management Group

This year Audit continued to communicate with DAIS and the Crown Solicitor's Office in addressing this matter in a joint consultative approach. Audit also referred the matter for consideration to the Prudential Management Group (PMG) in May 2001, in recognition of their role in government policy setting concerning private sector contracting arrangements.

In referring the matter to the PMG Audit expressed the view that:

- there should be appropriate clauses included in government contracts to allow agencies to monitor private contractors' performance. These clauses should provide for access and audit to relevant information;

- contractors to Government should be made aware of the role and function of the Auditor-General. Agencies should be encouraged to include in their contracts provisions which require the private contractor to cooperate with the Auditor-General;

- consideration should be given to ensuring the adequacy of safeguards over security, integrity and control of government information and processes, where the information and processes are managed by a private contractor to government.

Whilst the statutory provisions of the *Public Finance and Audit Act 1987* are mandatory and cannot be the subject of contractual exemption it would be constructive to include an appropriate clause in the contracts to overcome issues that have been raised in recent years in Audit's relationship with private sector entities.

Response from the Prudential Management Group

The PMG considered the matters raised by Audit and in its response of July 2001 advised the following.

Monitoring of Contractor's Performance — The PMG actively encourages agencies to include in their contracts provisions which will allow the monitoring of a contractor's performance. In addition the PMG will commonly invite agencies to provide a 'post implementation review' report on major contracts. These reports provide an opportunity for the PMG to test whether the monitoring arrangements are appropriate and, indeed, being utilised. In reviewing the reports, the PMG does not focus only on the contractor's performance, but also on the agency's performance.

Role of the Auditor-General — The PMG agrees that this matter should be raised with contractors and suggested that it would be appropriate that government contracts include a provisions as follows:

> *Auditor General*
> *Nothing in this contract derogates from the powers of the Auditor-General under the* Public Finance and Audit Act 1987 *(South Australia).*

The PMG intends to raise awareness of this issue by:

- including information in the 'Notice' section of the PMG website on the SA Government intranet;
- send a notice to all Portfolio Chief Executives, and the Chairperson of Accredited Purchasing Units;
- advising the Crown Solicitor's Office of the requirement to be included in government bid documents and contracts.

Adequacy of Safeguards — The PMG is mindful of this and commonly tests projects that it reviews as to the safeguards implemented. These types of issues commonly arise when considering the risks of a project and must be considered on a case by case basis.

Audit Comment

In reviewing contracting out arrangements Audit will review as an ongoing matter the nature and adequacy of access and audit rights.

CONCLUSIONS

Contract Disclosure and Transparency

Over the past few years my Reports have included specific commentary on various aspects of government contracting. One aspect that has been discussed is that of commercial confidentiality and/or public interest confidentiality.

A new Policy on Contract disclosure was released by the Government in May 2001. The Policy is directed to increasing transparency and accountability in respect of the Government's contracting activities.

Contracting Arrangements

Government and its agencies can enter into project and contracting arrangements that can involve the large outlay of public monies and/or commitments. The arrangements can be diverse in type, activity and complexity.

As in past years, audit review of certain contractual arrangements still give rise to issues that reveal inadequacies in contract management processes and performance accountability obligations.

Audit Access Arrangements

Audit has noted that State and audit access requirements are in some cases not adequately communicated to private service providers involved in contracts with government and/or not appropriately provided for in contracts.

This matter has been raised with the Prudential Management Group (PMG). The PMG is to raise awareness of this issue with government agencies.

GOVERNMENT PROCUREMENT OF GOODS AND SERVICES: A MATTER OF MAJOR EXPENDITURE OF PUBLIC MONIES: A MATTER OF CONTINUING AUDIT FOCUS

INTRODUCTION

In December 1996 the State Supply Board completed a review of whole-of-government procurement practices. The review concluded that the government could achieve multi-million dollar savings through implementation of a range of procurement reform initiatives.

The progressive implementation of reform to the procurement arrangements of public sector agencies commenced in 1998-99. The reform process has involved changes to the responsibilities of the State Supply Board and public sector agencies in respect of both 'goods' and 'services' acquisition processes.

A review of the legal, administrative and policy framework underpinning the reform process was finalised in August 2000 and was the subject of comment in last year's Report (ie 1999-2000). The Report stated that as a result of the Audit review, certain issues had been referred to the State Supply Board for clarification to ensure the soundness of the overall implementation framework.

During the year the State Supply Board informed Audit of the outcome of its consideration of the issues that had been referred to it by Audit in August 2000. In addition, Audit has completed a review of another critical aspect of the procurement strategy. The review centred on the major area of detailed policy and procedural guidance for good procurement process and practice by agencies of government. Several matters for improvement were identified from that review and raised with the Board. The Board has now responded.

This section of the Report comments on the Board's response to issues arising from the 1999-2000 Audit review, discusses the outcome of the 2000-01 review, and indicates the direction being taken by Audit concerning other areas of audit examination.

THE 1999-2000 REVIEW: LEGAL AND POLICY FRAMEWORK

Features of Procurement Reform

Last year's Report outlined the salient features of the procurement reform strategy. In brief these included:

- The reform involved changed roles and responsibilities of the State Supply Board and public sector agencies.

- A government endorsed policy framework 'SA Government Procurement Reform' (Purchasing Strategically) that underpins the reform changes. No change was effected to the *State Supply Act 1985*.

- The adoption of a unified approach to the purchasing of goods and services (Unified Supply Policy), including a role for the State Supply Board in relation to both goods and services.

- The State Supply Board, on the basis of accreditation, devolving purchasing accountability to public sector agencies with an oversight monitoring and support role provided by the Board.

- The establishment of Accredited Purchasing Units (APUs) within the relevant government agencies to support the agency Chief Executive in overseeing goods and services purchasing and tendering at the government agency level.

Audit Issues Referred to the Board — August 2000

The previous Report included comment on the issues arising from the 1999-2000 review and forwarded to the State Supply Board for examination and clarification.

In essence, Audit raised doubts concerning the lawfulness of the steps that were taken to confer upon the Board functions in relation to the procurement of 'services' as distinct from 'goods'. The procurement reform strategy (involving the Unified Supply Policy) was implemented principally through policy/administrative changes. No amendments were made to the *State Supply Act 1985*. Other issues were also raised for consideration and clarification, including the role and responsibility relationship associated with APUs in dealing with procurement matters involving more than one agency.

State Supply Board Response to Audit Issues

The Board, in consultation with the Crown Solicitor, considered the issues raised by Audit. The Crown Solicitor is of the view that the current legal basis for implementation of the Unified Supply Policy is not appropriate and that the *State Supply Act 1985* should be amended.

In recognition of this position, in early July 2001, Cabinet approved the drafting of a legislative amendment to the *State Supply Act 1985* to:

- provide for a unified approach for the procurement of 'goods', 'services', 'energy' and 'intellectual property' by public authorities;

- define 'goods', 'services', 'energy' and 'intellectual property';

- define 'works' for the purpose of clarifying the application of the provisions of the Act;

- provide for the constitution of the Board to include the Chief Executive Officer or delegate of the Department of the Minister to whom the *State Supply Act 1985* is committed.

The review of the Cabinet submission indicates that the Board may best deal with some other issues (for example, matters relating to APUs) by way of Board policy, once the Board's responsibilities in services procurement has been ratified through amending legislation to the *State Supply Act 1985*.

The Board advised Audit in September 2001 that it expected the amending legislation to be introduced into the forthcoming Spring session of Parliament.

THE 2000-2001 REVIEW: THE PROCUREMENT PROCESS: DETAILED POLICY AND PROCEDURAL GUIDANCE FOR AGENCIES

Background

The issues arising out of last year's review are significant to the overall soundness of the framework that underpins the strategic and operational procurement arrangements of government and its agencies. In recognition of this, and that certain issues were of a policy nature, Audit turned its attention in 2000-01 to the review of the related major area of policy and procedural guidance for agencies.

The nature and extent of prescribed policy and procedure that is available to agencies is seen as a critical foundation component for good procurement process and practice within agencies.

In reviewing the policy and procedural aspects, Audit was mindful of the government endorsed policy framework document of May 1998 'Purchasing Strategically' and the various policy documents published by the State Supply Board since that date. Audit also undertook an overview of policy and procedural related documentation at the agency level. Further, Audit also examined the position regarding this matter as it has been applied by the Victorian Government.

Responsibility for Policy and Procedural Formulation and Documentation

The responsibility for policy and appropriate procedural arrangements rests with both the State Supply Board and public sector agencies. However, the Government endorsed 'Purchasing Strategically' document communicated a clear expectation that the State Supply Board would take a lead role in this area. It was anticipated that as the procurement reform proceeded the Board would issue detailed procurement policies and guidelines to assist agency Chief Executives to develop and implement 'best procurement practices' (systems, structures, procedures).

In reference to the term 'best procurement practices' it was envisaged that such practices would accord with certain guiding principles to be applied by agencies to all procurement decision making strategies and practices. These principles include value for money, open and fair competition, professional integrity and probity, client service, management of risk and accountability.

Status of Detailed Instructive Guidance

South Australia

As mentioned, the endorsed policy document of May 1998 'Purchasing Strategically', has been followed by the publication of a number of Board developed and released policy documents relating to specific important interest items. Collectively these policy documents reflect a high level policy framework. The Board has not to date formally issued detailed instructive guidance to agencies concerning best practice procurement policies and procedures, nor has it issued formal instructive advice to agencies as to what those policies and procedures might comprise.

At the public sector agency level, Audit's overview assessment has revealed that policy and procedural development has (and is) occurring. Notwithstanding, to date, no comprehensive whole-of-government policies and procedures (as to the conduct of procurement processes, structured and focused on each step in the procurement cycle process) have been developed at the government agency level. It can be said that in most cases agencies have only advanced marginally beyond the high level policy framework material published by the Board.

This position is different when compared to the Victorian Government where there is a strong similarity in the strategies adopted to procurement reform in that State and South Australia.

Victorian Government Arrangements

The Victorian Government Purchasing Board (the equivalent of this State's State Supply Board) has published comprehensive policy and procedural material for agency adoption in that State. That material is deliberately structured around the five key steps in the typical procurement process, ie:

- planning;
- bid document preparation;
- invitation process;
- evaluation, selection and award;
- contract administration.

The Victorian material provides mandatory policies and recommended guidelines as to best practice at each step.

It is important to note that the Victorian Government in 2000 commissioned an external consulting firm to review government purchasing arrangements in that State (Victoria had in recent years implemented reform arrangements of a similar nature adopted in South Australia). The review concluded in relation to the area of policy and procedure that, although there was scope for improvement, the Government had struck an acceptable balance between devolution of authority and accountability on the one hand, and central quality assurance on the other.

Audit Observations and Comments

Comment in a General Context — Improvement in Policy and Procedure Formulation

Audit is of the opinion that there is substantial merit in the approach that has been (and is being) taken in Victoria to procurement policy and procedural guidance development and that it would be of advantage for South Australian authorities to review this material.

It is the view of Audit that in South Australia considerable improvement is required in the areas of direction and development concerning instructive procurement policy and procedural formulation. The development of a standard (or default) set of policies, procedures and best practice guidelines focused on the procurement process itself would be invaluable to agencies in the following respects:

- The policy and procedural material would reflect best practice standards and requirements.
- The material, in whole or part, may be quickly adopted by agencies where limited policy and procedural documented guidance has been produced.
- The material would facilitate formulation of customised policy and procedures by agencies, where appropriate.

It is suggested that a dedicated resource effort, lead by the Board with coordinated resource input from all Accredited Purchasing Units of the Portfolio mainline agencies, may represent an approach to efficiently and effectively achieve the marked improvement required in policy and procedural formulation. The coordinated approach would, in itself, reduce any administrative duplication and divergence in the formulation process.

Comment in a Specific Context — Consultancy/Contractor Policy Guidance

An illustrative example of the benefits to be derived from a coordinated approach to policy and procedural development relates to instructive guidance in regard to consultancy/contractor service acquisition.

Previous Reports have included comment on the importance of agencies of government ensuring the integrity of processes involved in the engagement of consultants and contractors in order to mitigate financial risks for themselves and government.

In making those comments, it was recommended that the Government revisit and then promulgate to all public authorities instructive guidance regarding service acquisition in accordance with principles that were developed by the Department of Treasury and Finance in 1995.

Although to-date that recommendation has not been taken up, Audit noted in reviewing the status of policy documentation activity at agency level, that the Strategic Purchasing Unit of the Department of Human Services has developed and issued detailed guidance on this topic during 2000-01.

Audit considers that the guidance implemented within Human Services could be used as a basis for development and promulgation of a government-wide (possibly a Board) endorsed policy guidance for this material area of service acquisition.

Referral of Audit Issues and Board Response — September 2001

Audit assessment in respect of the state of policy and procedural guidance, including the requirement for considerable improvement in the areas of direction and policy formulation processes, was referred in writing to the Chairperson of the State Supply Board in early September 2001.

The Chairperson of the Board has responded in a positive manner to the Audit communication. In responding the Chairperson has indicated the following:

- Since commencement of the procurement reform program major emphasis has been placed on providing agencies with the skills and knowledge to undertake effective processes.
- Policy and procedural development has been occurring within agencies. The Board, however, recognises the need to move beyond providing agencies with mainly high-level policy to that of providing clear leadership in procurement improvement, including the development of best practice guidelines and a more detailed set of procedural instructions.
- The Board established in March 2001 a dedicated resource unit to assist procurement leadership and improvement initiatives.
- The Board is to review published material of other States as part of its current process of developing best practice procurement guides. Roll out of guides in a phased way is anticipated from November 2001.

AUDIT REVIEW DIRECTIONS

By any measure, a key element of public sector procurement processes is the quality of the tendering and contracting processes undertaken by agencies. Audit has drawn attention in past Reports to concerns regarding the conduct of these important processes by agencies.

Certain matters concerning the quality of the conduct by agencies of these processes and, of outcomes achieved, have also been raised in the Parliament.

As mentioned, the provision and availability of comprehensive policy and procedural guidance at agency level is a critical foundation component for good procurement process and practice within agencies. As the 2000-01 review outcome and the Board's response suggests, much improvement is required and this process has commenced.

The existence of comprehensive policy and procedural guidance, by itself, will not ensure good procurement process and practice. Deficient conduct or execution of procurement processes, can cause government and agencies to fall short of the guiding principles that underpin procurement reform.

Audit is to direct attention in 2001-02 to the quality of execution of aspects of the tendering and contracting component of the procurement process cycle. This subject review area will also consider the nature and extent of waivers of competitive processes and the reporting accountability associated with this matter.

Audit will also look at the area of electronic procurement initiatives in development or operation. This area was seen as important to procurement reform in achieving economies.

CONCLUSIONS

The Government through its public sector agencies spends millions of dollars annually on the acquisition of goods and services.

The implementation of the procurement reform strategy, and its intended direction to achieve significant economies, has warranted this area of government operations receiving specific and continued Audit attention since 1999-2000.

1999-2000 Audit Review Outcome

The review identified issues relating to the legal and policy framework that underpins the soundness of the procurement reform strategy. In essence, Audit raised doubt concerning the lawfulness of the steps that were taken to confer upon the State Supply Board functions in relation to the procurement of 'services' as distinct from 'goods'.

The Board advised Audit during 2000-01 that clarification regarding this matter was undertaken, and that Cabinet, in July 2001, approved the drafting of amending legislation to the *State Supply Act 1985*. It further advised that it expected the amending legislation to be introduced into the Spring session of Parliament.

2000-01 Audit Review Outcome

As a follow on to last year's Audit review of the legal and policy framework of the reform strategy, Audit, in 2000-01, reviewed the nature and extent of prescribed policy and procedure that is available to agencies as the foundation component for good procurement process and practice.

The review found that considerable improvement is required in the area of direction concerning policy and procedural formulation and the actual development of best practice procurement policies and procedures. Audit considered that the Board, with coordinated resource input from agencies, may represent an efficient and effective approach to achieve a considerable improvement in policy and procedural development.

This matter was referred to the Board in early September 2001 and an immediate response outlining positive developments to address the required improvement was received.

A Matter of Continuing Importance and Focus

It is most important that the identified shortcomings in the legal and policy framework and in the area of prescribed policy and procedural guidance for agencies is properly and quickly addressed. This will provide a strong foundation and support for the Board and agencies in achieving the guiding principles for procurement decision making and practice.

Audit will undertake reviews of other aspects of goods and services procurement considered important in the context of the guiding principles and achievement of economies.

IT POLICY, MANAGEMENT AND CONTROL ISSUES

INTRODUCTION

Over the past few years I have reported on the important matters of Information Technology (IT) policy and major Information Technology developments both within and across government agencies. In so doing I have stressed the need for appropriate planning and policy procedure guidance.

In a broad sense, the importance of a plan and need for management and policy guidance is brought about by the increasingly changing electronic business environment and ongoing adoption and operation of web based electronic commerce systems for communication and financial transactions by government agencies.

Major agency developments are taking place in this fast moving ever changing technological environment which present increased management and security control risks for both government and its agencies. It is now increasingly important for the Government to plan for and guide government and agency developments, particularly in the emerging area of electronic commerce and Internet based service delivery of financial and information services.

Last year I specifically indicated the requirement for a plan to communicate the Government's IT direction and expectations, and for effective monitoring to be undertaken of those significant projects of government agencies identified in the plan with respect to planned achievements. The Department of Administrative and Information Services (DAIS) has taken a lead role in development of an IT Plan and associated policy standard guidance.

Significant progress has been made during the year under the lead agency of DAIS in respect of these matters.

This section of the Report comments on the progress of these developments. The developments have been reviewed in the context of specific examination of two areas of current emerging uses of IT.

The outcomes of these two specific reviews and Audit's comment and observations is contained in the next two sections of this Report. These relate to certain Legal, Policy, Privacy and Control aspects of Electronic Government, and a review that concentrated on the security and control arrangements for the Government communications network (StateNet).

IT STRATEGIC PLAN

In October 2000, Cabinet endorsed the whole-of-government plan for information technology, notably, the 'Information and Communication Services Directions' Plan (ICS Directions). The ICS Directions document represents a major step for government Information Technology management, in that it is the first iteration of a whole-of-government plan.

Governance of the Plan is vested in:

- the Senior Management Council, which consists of the Chief Executives of the 10 portfolio agencies;
- the Chief Information Officers Forum, represented by senior Information Technology representatives from the 10 portfolio agencies;
- DAIS as the lead Information Technology agency of government.

The Chief Information Officers Forum was the main body involved in the development of the Plan details.

Key Plan Components and Developments

The Plan is essentially a three year rolling program. Key elements of the Plan involve the recognition of significant projects of government agencies, the expanded use of Internet technologies by agencies, and the securing of agency Information Technology assets, systems and information. The Plan adopts a co-operative cross-agency approach to strategic planning and envisages the promulgation of appropriate ICS Policies and Standards to assist interaction between government agencies and encourage consistency in government-wide outcomes. In broad terms, the Government aims to make all appropriate information and services available electronically.

As mentioned, Governance arrangements are partly vested in the Senior Management Council. These arrangements are achieved through an Information and Communication Services Committee of the Council. This Committee is responsible for driving the adoption of the Plan within agencies, monitoring progress, aligning portfolio interests and determining which portfolios drive key projects. The Chief Information Officers Forum is responsible for the operational management of the Plan, and DAIS is responsible for the development, delivery, custodianship and review of the Plan. Present monitoring includes DAIS's active involvement with agency plans through various forums and project groups and particularly the Chief Information Officers Forum.

ICS Directions envisages the development of a number of key strategic documents, including an Information Management Framework, Information Security Framework and Value Measurement Guidelines. Those documents are essential for managing information and the security of information, and for measuring agency achievements under the Plan.

The Plan provides high-level strategic actions to be achieved for government and its agencies. Implementation of the Plan's key strategies will occur within the activities of all agency portfolios and will be coordinated across government where appropriate. All resourcing for agency developments and initiatives is to occur within agency portfolio budgets.

The ICS Directions document was endorsed by the Senior Management Council — Information and Communication Services Committee and Cabinet in 2000-01. Details of the Plan have been made widely available by provision of a specific web site directed towards the Plan contents.

Audit communicated formally with DAIS regarding the Plan developments. DAIS advised that the Plan would be subject to annual reviews to reassess the currency of the strategic directions proposed and the progress towards the actions defined. The first annual review is planned for late 2001.

Audit Observations and Comments

As mentioned, significant developments have been made towards the Plan finalisation. Audit's observations and comments regarding certain aspects of these developments are commented on below.

Governance Arrangements — The Senior Management Council - Information and Communications Services Committee, the Chief Information Officers Forum, and DAIS are significant contributors to the overall Plan process. For a major project of such a far reaching nature as this, Audit believes it crucial that the involvement of the Chief Executives (as represented by the Senior Management Council) be maintained.

Key Strategic Documents — Certain proposed key documents, notably, the Information Management Framework, Information Security Framework and the Value Measurement Guidelines are clearly important documents.

The Information Management Framework document in particular needs to be completed at an early stage of Plan development. This document, which is pivotal in the Plan's execution and direction, has yet to be completed. This may pose some potential risk that the planned strategies and projects being progressed will not be entirely appropriate to the Information Management Framework when finalised. The involvement of the Chief Executive and the Chief Information Officers in the preparation of the framework is essential to minimise such risk.

Significant Initiatives of Government Agencies — The Plan provides high-level strategy actions to be achieved for government and its agencies. It is not clear how these strategy actions will be recognised in agency strategic plans nor is the relationships/dependencies evident between these actions. It is important that the dependencies between these strategy actions, and the recognition and coordination of agency strategic plans be formally documented.

Monitoring of Planned Achievement — The ICS Directions document itself does not provide an expectation of key government agency initiatives, proposed completion timeframes, and benefits to be achieved, against which future efforts and outcomes can be measured. It would be beneficial to incorporate planned agency developments and expected outcomes into some formal plan documentation.

Audit will continue to relate and communicate with DAIS with respect to these matters.

POLICY AND STANDARDS GUIDANCE

The Government has developed a number of IT policies and standards relevant to government agencies which broadly cover the following areas:

Information Technology (IT Policies) — The policies provide mandated guidelines for agencies with regard to the management and ownership of government data, information, software, hardware, and management of government Information Technology infrastructure in an outsourced environment. The policies essentially deal with custodianship, privacy and confidentiality, security, Internet access and usage, and Internet web page design.

Information Technology (IT Standards) — The standards cover IT products, suppliers, and protocols which are to be used by government agencies. The standards broadly address implementation for whole-of-government hardware, systems control software, application service and software, and communication and distribution services.

Past Reports have commented that it was desirable that the IT Policy and Standards framework be revisited in the light of the changing technological environment and developing codes of practice in emerging areas of Information Technology. In that context, the following commentary summarises more recent developments with respect to this matter.

As mentioned, DAIS is managing a number of projects contributing to the review of the Government's information security policies, standards and guidelines. This includes the development of a new framework (government Information Security Framework), under the ICS Directions Plan as outlined in the previous section of this Report. Agencies will construct and implement their own security plans in accordance with the framework.

The first part of the security framework development addresses policies, standards, risk analysis, data classification and control mechanisms based on Australian Standards. Its development is being facilitated by external contracted expertise, with input from a government reference group. A number of Best Practice Guidelines are also being developed with the assistance of external contract expertise.

At the time of preparation of this Report, the Department was also in the process of establishing a Government Information Security Manager position responsible for all whole-of-government information security matters.

The project to review government standards and guidelines for ICS requires priority for completion and communication to government agencies.

Audit formally communicated with DAIS on these developments, and the Department advised that the framework proposal had been through an extensive consultation process and was approved by the Minister in August 2001 for submission to Cabinet. A full review of the Government's current ICS policies, standards and guidelines is planned to be completed by DAIS by late 2001.

Audit Observations and Comments

At the time of preparation of this Report, the first part of the Information Security Framework project had reached an advanced stage of finalisation.

Notwithstanding these developments, Audit is of the view that there is a need for some priority to be given to promulgation of appropriate guidance to agencies of a policy, strategy and direction nature in the context of developing technologies such as the Internet and e-commerce. Such high level guidance would provide direction and complement operational guidance provided by the DAIS planned Information Security Best Practice Guidelines.

Audit will continue to relate and communicate with DAIS with respect to these matters.

CONCLUSIONS

Strategic Planning and Policy Guidance

In my previous Reports to Parliament, I commented that the changing Information Technology environment within which government agencies operate demands there be adequate strategic planning and policy guidance in place to facilitate the implementation and control of major IT initiatives of government agencies. Audit acknowledges the progress made by DAIS in developing and communicating the Information and Communication Services Strategic Plan (ICS Directions) and for commencing key initiatives and projects required to achieve effective implementation of the Plan and associated policy guidance.

Governance of the Project

Notwithstanding the developments identified above, Audit has identified that sound governance arrangements for this project is crucial for the success of the Plan and that the involvement, direction and oversight of the Senior Management Council is essential.

Planned significant projects and actions to be initiated by government and its agencies, appropriate for achievement of the Plan, need to be prioritised, developed and monitored by the Senior Management Council, DAIS and the agencies. Audit considers it is important that effective recognition, coordination and monitoring are undertaken in respect to targeted outcomes and planned achievements.

Completion, Implementation and Communication of the Plan

Audit considers that key document deliverables identified within the Plan are essential for planning and direction setting and that these deliverables should be completed at an early stage of development. At the time of preparation of this Report, some pivotal documents such as the Information Management Framework had not been completed.

Audit reiterates that there is a priority for completion, implementation and communication of the ICS Directions Strategic Plan and associated management and policy documents to agencies of Government. This is particularly so given the rapidly changing electronic business environment and electronic commerce initiatives of government agencies and the associated risks of operating in that environment.

SOUTH AUSTRALIAN GOVERNMENT COMMUNICATIONS NETWORK (STATENET)

EVOLUTION, FUNCTIONALITY AND STATUS REGARDING SECURITY AND CONTROL ARRANGEMENTS

EXECUTIVE SUMMARY

Introduction

StateNet — What is it?

The State Government wide area network, StateNet, is essentially an interconnection of government agency networks providing the means for agencies to communicate electronically with each other. That communication network, in very general terms, is a platform supporting links within and between agencies for information exchange, as well as providing access to the Internet and external mail services for agency staff. A shared central StateNet Gateway provides a link between the agencies and the Internet allowing external users to reach operational and financial transaction web services provided by government agencies.

In more recent times, StateNet has evolved and expanded in an attempt to meet the increased demands of government agencies in delivering sophisticated online information and web applications to the public through StateNet.

As a result, StateNet has become ‘business critical’ for agencies and government.

World wide increases, and related publicity, concerning computer viruses and Internet hacking demonstrate the need for sophisticated security access controls and effective monitoring of access to the government’s StateNet communications network.

Government Agencies and StateNet

Government agencies are becoming increasingly dependent upon secure, reliable communication networks given the growth of use of the Internet and electronic commerce and the processing and transmission of important government information via the StateNet network. The potential risks of failure because of inadequacies and inefficiencies in network management, design, control and security are emphasised because of these dependencies. Without adequate controls the Government is exposed to the risk of loss of revenue, breaches of privacy and confidentiality, unauthorised disclosure of sensitive information, damage to public image and loss of trust in government capabilities.

Audit Review

In recognition of the critical nature of StateNet, Audit has undertaken a review to assess its current status, not only against the background of the emerging needs of government agencies in support of e-commerce type activities, but to also consider the important matters of security and control over the access to the network and the protection of sensitive government information.

Audit's review of StateNet addressed the important matters of management and ownership of the network, network design and management of changes, and network operation and security aspects.

The review findings were communicated to the Department for Administrative and Information Services (DAIS) in December 2000. The response from the Department outlined the action being taken to address the matters raised. At the time of preparation of this Report that action had not been finalised.

Structure of this Section of the Report

My introductory comments have explained the importance of this matter. The key findings of the review and response of DAIS are outlined below.

The latter part of this section contains more detailed commentary with respect to the review scope and findings, including some specific comment on risks identified and Audit's recommendations.

A Guide to Readers

To assist the readers understanding of this section of the Report, a diagram depicting the conceptual design of the State Government Wide Area Network (StateNet) is provided herein, with a glossary of Information Technology terminology as Appendix I.

Key Findings

The review identified significant weaknesses in a number of important management, design and security matters associated with StateNet. The key issues identified are summarised under three broad categories:

- policy and ownership;
- network gateway design and management;
- network operation.

Policy and Ownership

It is imperative that a single entity (agency) has 'ownership'/control, responsibility and accountability for StateNet and the shared central StateNet Gateway and the policies under which it is operated, even though this service is shared. This agency would be in a position to set direction and provide funding for the update of infrastructure as requirements and risks change over time, as well as performing (on behalf of all agencies), security monitoring of access control functions.

Network Gateway Design and Management

Audit considers the controls associated with the protection against external interference with the shared central StateNet Gateway to be inadequate, increasing the risk that agency Internet services may be shut down or otherwise compromised.

Further, security management under the current arrangements is complex and likely to be subject to interruptions to government agencies as security changes are made.

There is also limited capability within StateNet to provide for failure of key items of equipment.

Network Operation

In Audit's view, significant deficiencies exist with respect to logging, alerting and response management arrangements for securing StateNet and the shared central StateNet Gateway Internet environment. This is particularly of concern, given the high risk of attack from the Internet community.

DAIS Response

In response to the matters raised, DAIS indicated that the review findings would assist the Department in consolidating a number of activities aimed at improving security and authorised access via the Internet to government services and information resident within StateNet.

In particular, DAIS advised it was progressing a 'Central Internet Gateway White Paper' (White Paper) aimed at establishing improvement and future directions for the Government's current central Internet access arrangements and had also implemented a full review of information security policies, standards and guidelines. Key matters raised by Audit have been included or given higher prominence in the White Paper and the Information Security Review.

DAIS also acknowledged that it is best placed to undertake a lead role in both security policy standards and responsibility (on behalf of government agencies) for key parts of the StateNet network, including the shared central StateNet Gateway.

Conclusions

What are the Risks to Government?

Controls over StateNet and the shared central StateNet Gateway are of utmost importance to the protection of key government agency information within StateNet and also for internal agency networks that are connected into StateNet, particularly with regard to government agency financial transaction processing.

While effort has been made to ensure security, new viruses and other new threats continue to emerge. Any weaknesses in security access controls and monitoring processes plainly put at risk government business and service operations. The consequences of not maintaining thorough and up-to-date security have been clearly demonstrated in the broader community on a number of occasions, evidenced by frequent media reports of computer and network failures affecting financial institutions, government authorities and the public.

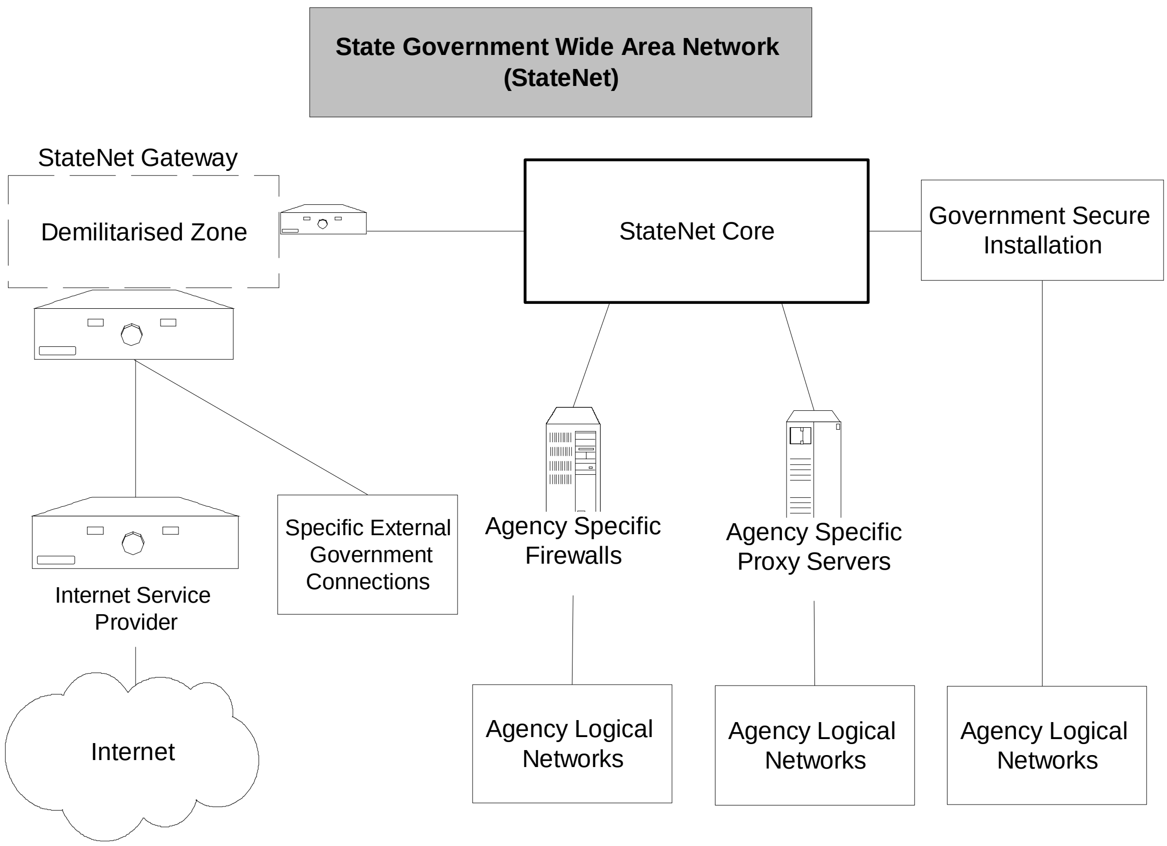
What Needs to be Done?

It is apparent from the audit findings that work needs to be done to improve management and security arrangements concerning StateNet. Audit is of the opinion that the DAIS projects and initiatives to review ownership, management and security issues for StateNet are critical to ensure the protection of government agency information and financial transaction systems and require priority for completion and communication to agencies.

THE STATENET COMMUNICATIONS NETWORK

As previously mentioned, StateNet is an interconnection of SA Government agency networks, providing the means for connected agencies to communicate with each other.

A shared central StateNet Gateway is also in place to provide a link between the agencies and the Internet, to allow external users to reach web services (some financially oriented) provided by agencies, as well as providing access to the web and external e-mail services for agency staff. Some specific agency sectors are connected into StateNet through independently established Internet gateways for their own use in order to meet the specific needs of their organisations. This is illustrated by the following diagram.



The following commentary describes various aspects of StateNet and its importance in terms of security of government information and responsibilities of stakeholders. It also includes the key Audit findings and recommendations made and identifies action taken or proposed by the DAIS with respect to the issues raised by Audit.

Management of StateNet

In 1995 the South Australian Government outsourced its IT infrastructure services to EDS (Australia) Pty Ltd. The infrastructure requirements that have been outsourced fall into five 'business segments' — mainframe, midrange, workstations, local area networks and wide area networks, including operating software systems and some database management systems. The StateNet communications network infrastructure falls under these arrangements.

Broadly, DAIS manages the IT infrastructure contract for the State and currently has a coordinating role with respect to StateNet.

Design and Operation

The basic network design as it currently stands has not changed substantially since the transfer of the network infrastructure to EDS in 1996. However, since that time, the importance of the Internet as a business and government enabler has grown enormously. Agencies are developing significant services that are delivered through the Internet, and agency staff are using the Internet as a core communications tool and information source in their everyday activities.

In light of these changes, security issues are becoming increasingly important. The risk of unauthorised access to agency networks is increasing as external attacks through poorly secured and monitored Internet gateways become more sophisticated and more frequent.

Controls over the shared central StateNet Gateway are critical to the protection of network traffic within StateNet and also for internal agency networks that are connected into StateNet.

The Internet mail gateway contains anti-virus detection software which performs scanning, detection and removal of viruses on incoming email. Network access checking is performed at the 'demilitarised zone' (refer to diagram) to control access into StateNet.

Policy and Future Directions

The use of the Internet in government has evolved from being simply a method for sourcing information from World Wide Web (WWW) sites to the predominant means for the delivery of communication and services within government and between agencies and the public. The Government is actively encouraging this approach through several initiatives and directives.

As mentioned, DAIS has a number of projects underway which address the protection and security of government agency information. One key project, which has been the subject of comment in the section in my Report titled ‘IT Policy, Management and Control Issues’, is the Information Security Framework project which will include further consideration of current Internet security issues. Those issues cover matters such as mechanisms for control of computer access, detection of unauthorised users, secure private networks, and prevention, detection and recovery from infection by computer viruses.

The rapid evolution of the use of Internet is expected to continue for the foreseeable future. Policies and standards for Internet use and security considerations established at the time of transfer of infrastructure to EDS are not now sufficiently comprehensive in the current changing Internet environment.

With respect to government agencies, because of the introduction and operation of significant e-commerce business activities using the Internet, such as the Department of Industry and Trade’s Bizgate e-commerce operations and other agency initiatives, Audit believes it appropriate for DAIS to maintain a formal ongoing liaison with respect to strategic policy direction and provision of security matters. This is an important matter in consideration of the strategic direction of government and its agencies in developing and operating such web based Internet facilities and requires promulgation of appropriate policies and guidance. This is subject to specific comment in the section in my Report titled ‘Electronic Government, Legal, Policy, Privacy and Control: Issues of Importance’.

STAKEHOLDER RESPONSIBILITIES

DAIS Role and Responsibilities

EDS provides the Central StateNet Internet Gateway infrastructure (with the exception of Central Internet Service Provider services). The EDS IT Infrastructure contract is managed by DAIS. In a broader context, DAIS has acknowledged that it is best placed to undertake a lead role in both security policy standards as well as responsibility (on behalf of government agencies) for key parts of StateNet, including the shared central StateNet Gateway.

DAIS is now moving to establish its role as the entity responsible for the core network and shared central StateNet Gateway and has identified the need to establish a Government Information Security Manager position.

Agency Responsibilities

In relation to the role of individual agencies, DAIS advised that many portfolios are moving to take greater responsibility of data networking arrangements within their own domain, resulting in a more easily identifiable boundary line between the core of the network and intra-agency network infrastructure.

AUDIT REVIEW FINDINGS

Scope of the Review

The StateNet review primarily focused on:

- considering provisions in place for the management of the network;
- obtaining high level overview of the network components and design, focussing mainly on StateNet and the shared central StateNet Gateway, to identify potential control weaknesses;
- reviewing change management processes;
- considering logging, monitoring and follow up processes associated with security.

The Audit review was undertaken in accordance with generally accepted auditing standards, and included enquiry, observation and review of appropriate documentation and other verification and testing procedures as considered necessary.

Audit Findings and Recommendations

Audit identified a number of important management, design and security matters associated with StateNet.

The key issues are commented on below under three broad categories:

- policy and ownership;
- network gateway design and management;
- network operation.

The response from DAIS regarding Audit's observations and recommendations is also summarised for each key issue category.

Policy and Ownership

In order for StateNet and the shared central StateNet Gateway to be operated effectively, Audit considers it is imperative that a single entity (agency) has 'ownership'/control, responsibility and accountability for StateNet and the shared central StateNet Gateway and the policies under which it is operated, even though this service is shared. This agency would be in a position to set direction and provide funding for the update of infrastructure as requirements and risks change over time, as well as performing (on behalf of all agencies), security monitoring.

Identified Risks and Audit Recommendations

The key risks identified and Audit's recommendations made with respect to the findings under this category are:

- StateNet and the shared central StateNet Gateway ownership;
- management of external network connections from agencies;
- approval and documentation of testing — firewall changes.

StateNet and the Shared Central StateNet Gateway Ownership

StateNet and the shared central StateNet Gateway does not currently have a formally identified owner that is accountable for key decisions that may impact across agencies. EDS, as manager of the infrastructure, may be making decisions without formal direction and guidance from an acknowledged SA Government 'owner'.

There may be a risk of less than clear formal designation of ownership and responsibility for StateNet and the shared central StateNet Gateway which may lead to inconsistent application of standards, security policies and issue resolution. This may result in the increased potential for StateNet and connected agencies to be compromised, impacting upon the confidentiality, integrity and availability of agency data.

It is recommended that an appropriate owner for StateNet and the shared central StateNet Gateway be identified as a high priority. While DAIS has had a coordinating role, Audit considers a more comprehensive role is necessary. This would require relevant Internet security skills and experience to fulfil this role and an updating of the StateNet network security infrastructure.

Audit recommends that DAIS take on the single entity (agency) 'ownership'/control, responsibility and accountability for the StateNet network and shared central StateNet Gateway.

Management of External Network Connections from Agencies

Existing standards for Internet use and security considerations were developed prior to the broad adoption of the Internet, and only very limited guidance is provided to agencies in this regard. Therefore, the level of protection and control that may be in place over external network connections is likely to be inconsistent.

Without clear policies regarding external Internet connections, StateNet and agency networks may be exposed to increased vulnerabilities as the security provided by approved gateway connections are bypassed.

Audit recommends a consolidated policy regarding external connectivity be produced. In addition, Audit recommends all external connections be recorded centrally to ensure compliance with government policy and that a review of all agencies external connections be conducted to accurately identify existing connections and to confirm compliance with existing policies.

Approval and Documentation of Testing — Firewall Changes

The management of testing and implementing of changes to access security arrangements is fundamental to maintaining effective control over access through StateNet and the shared central StateNet Gateway.

In the light of StateNet's design complexities, there is a risk that such changes may compromise the integrity, confidentiality and availability of agency data, both on StateNet and within agency internal networks that are linked to StateNet.

It is recommended that DAIS revisit and enforce guidance and responsibility for testing of services subsequent to changes, such that services that should not have been affected by the changes have not been inadvertently impacted. The guidance would confirm the minimum requirements in relation to the testing to be performed for changes to StateNet infrastructure.

DAIS Response — DAIS acknowledges that it is best placed to undertake a lead role in both security policy standards as well as responsibility (on behalf of Government agencies) for key parts of the StateNet network, including the shared central StateNet Gateway. It is now moving to establish its role as the entity responsible for the core network and shared central StateNet Gateway.

DAIS has identified the need to establish a Government Information Security Manager position responsible for all whole-of-government information security issues, including responsibility for centrally managed security infrastructure, implementation and management of government information security policies, central information security advice and auditing functions.

DAIS intends to establish a StateNet consultative group to assist with coordinating agency technical input into common standards and action plans aimed at improving the robustness of the network.

Network Gateway Design and Management

In terms of network design, it is general industry practice to implement controls to limit or manage external user access to an organisation's internal network. These controls generally focus on isolating the internal network from the Internet and establishing a partially controlled network segment (often referred to as the 'demilitarised zone') that is accessible from the external network while still protecting the remainder of the internal network.

Audit considers the controls associated with the protection against external interference with the shared central StateNet Gateway to be inadequate, increasing the risk that Internet services may be shut down or otherwise compromised. Further, Audit noted that security management under the current arrangements is complex and likely to subject government agencies to interruptions as security changes are made. Audit also considers that there is limited capability within StateNet and the shared central StateNet Gateway to provide for failure of key items of equipment.

Identified Risks and Audit Recommendations

The key risks identified and Audit's recommendations made with respect to the findings under this category are:

- general design of shared central StateNet Gateway security;
- maintenance of access controls;
- security penetration testing;
- network resilience.

General Design of Shared Central StateNet Gateway Security

The current security access arrangements throughout StateNet and internal agency networks is complex and is likely to be subject to service interruptions as changes are made, either through loss of service through conflicting access rules or errors in configuration or relaxing of the security barriers.

There is a risk that the firewall in its current configuration may provide some exposure of agency networks and StateNet to external attacks.

It is recommended that a detailed review of the design of the shared central StateNet Gateway be undertaken to assess the potential to improve security through the full implementation of a more effective firewall solution. Audit recommends changes be justified on the basis of the extent of potential access into StateNet and the risk to agency data, balanced against the cost and performance impact of any proposed change.

Maintenance of Access Controls

Even though current access control mechanisms are capable of being used to control network access, there is some question as to the maintainability of these controls. The complexity of the existing control arrangements potentially compromises the security of StateNet. This is not an acceptable situation.

It is recommended that full firewall access control be implemented with the aim of using the simpler mechanisms provided to improve the maintainability of these controls. In implementing the new control strategy, a comprehensive review of access requirements should be undertaken, to provide the basis for the new firewall controls. Obsolete and redundant rules associated with the current approach should not be carried over to the newly established firewall access control mechanisms.

Security Penetration Testing

In addition to traditional reviews of security settings for firewalls and web servers, many organisations are adopting a policy of performing regular security penetration testing as an effective approach to confirm that firewall controls and the monitoring and logging procedures that support an Internet Gateway are operating effectively. For the shared central StateNet Gateway, no such regular security penetration testing had been formally performed by either EDS or a third party.

There is a risk that deficiencies in control processes may go undetected unless adequately tested.

Audit recommends that a schedule be established for regular penetration testing to confirm the operation of the controls that surround the shared central StateNet Gateway.

Network Resilience

Currently, there is limited backup or additional capacity for a number of key hardware devices that support StateNet. Elements of StateNet provide single points of failure with the potential to impact a significant portion of the network for both inbound and outbound traffic through the shared central StateNet Gateway. The network design should provide for a level of redundancy that reflects business needs in the context of e-business services.

There is a high risk that a continued lack of capability within the shared central StateNet Gateway exposes StateNet to loss of service through failure of equipment which may result in loss of reputation and revenue as web, information and transaction services are unavailable whilst faults are resolved.

It is recommended that a review of StateNet and the shared central StateNet Gateway be conducted to identify and document the critical components vulnerable to failure and proposed actions to be taken to address the risk.

DAIS Response — DAIS confirmed a Central Internet Gateway White Paper addresses the issue of external network connections and proposes alternative strategies.

DAIS is moving towards adoption of the Information Security Management Standard AS/NZS 4444 as an eventual replacement for the 'South Australian Government Information Technology Security Standards In An Outsourced Environment' document. This Information Security Management Standard addresses current Internet security issues such as firewall requirements, secure web hosting, virtual private networks, web viruses, hacking, intruder detection and denial of service attacks.

The Department has engaged the services of external consultants to help create the South Australian Government's new Information Security Framework, and develop new policies, standards and best practice guidelines, in accordance with the AS/NZS 4444 standard.

DAIS also supports improved network access controls and has proposals for service-wide improvement in this area.

A key project of the new Information Security Framework is the performance of penetration testing arrangements of key government applications and entry points. At the time of preparation of this Report, DAIS advised Audit that high-level transaction analysis of the StateNet perimeter devices, between StateNet and the Internet, was to be performed.

Network Operation

Incidents and reports of attacks are becoming more and more common over time. As software complexity increases, security flaws are identified and tools that assist attackers are developed and made available to an increasing Internet user base. In this environment, the operation of a network requires ongoing management and maintenance, to apply security patches in a controlled manner as they become available, and to monitor network traffic to identify and take action on attempted attacks.

For StateNet and the shared central StateNet Gateway, standard EDS change management processes are in place to provide control over the application of security patches and the update of access rules. However, the complexity of the network environment as it currently exists has added to the potential for errors or omissions.

There may be some question as to responsibility for responding to a security incident once it is identified. No single agency is responsible for StateNet in that it is seen as a shared service that is used by a wide range of agencies.

It is considered that significant deficiencies exist with respect to logging, alerting and response management arrangements for securing StateNet and the shared central StateNet Gateway Internet environment. This is particularly of concern, given the high risk of attack from the Internet community.

Identified Risks and Audit Recommendations

The key risks identified and Audit's recommendations made with respect to the findings under this category are:

- user and agency accountability — Internet usage;
- logging and monitoring of Internet activity.

User and Agency Accountability — Internet Usage

Enforcement of policy provisions in relation to Internet usage will normally require that audit trails provide a reliable source of evidence of user activity that can be traced to an individual user.

It is considered the internal network design does not enable network management staff to effectively identify user activity or use of the Internet, and therefore agencies and users may not be held accountable for their activity. Thus, agencies may be unable to enforce their Internet usage policy and may expose the Government to legal liability in the event of users committing illegal activities from within StateNet.

Audit recommends a detailed examination be undertaken into the mechanisms to be used by the government Internet service provider to best identify user activity use of the Internet and facilitate agency enforcement of Internet usage policy and verification of charges made.

Logging and Monitoring of Internet Activity

Given the nature of the Internet and the potential for attack, it is imperative that attempts of network intrusion are identified and actioned as they occur, relying on effective logging mechanisms that are available within firewalls.

In Audit's opinion, the shared central StateNet Gateway firewall logging and monitoring controls are inadequate. Consequently, the confidentiality, integrity and availability of information and services within both StateNet and connected agency networks may be put at risk.

Audit recommends a facility be enabled within the shared central StateNet Gateway Internet connection for the effective logging of inbound and outbound network traffic to a secure location that is retained for an appropriate period. Alerting should also be configured to enable a more immediate identification and response to attempted attacks on StateNet and agency networks through the shared central StateNet Gateway.

Audit also recommends that the responsibilities of the SA Government and EDS in relation to log review and follow up be revisited to clarify specific responsibilities in this regard. Wherever the responsibility falls, that entity should establish a formal security structure with responsibility for managing security related issues with respect to StateNet operation. In addition, formal security plans (including incident response plans), should be revised detailing responsibilities and reporting procedures for both EDS and the agency responsible for StateNet security management.

DAIS Response — DAIS and EDS are currently preparing a joint proposal to perform a physical security audit of StateNet with a view to forming short, medium and long-term actions to address current shortfalls and future design requirements. The Central Internet Gateway White Paper outlines options and revised strategies for improved firewall and security functions.

As part of the ongoing information security review of StateNet the new AS/NZS 4444 based policies, the physical security audit of StateNet and the White Paper will all contribute to the redesign of the StateNet security architecture, proposed for the first quarter 2001 - 2002.

CONCLUDING COMMENTS

Outcome of the Audit Review

The outcome of the Audit review identified significant weaknesses in a number of important management, design and security matters associated with StateNet.

The review findings together with recommendations were formally communicated to DAIS. In response DAIS have indicated certain actions taken to address the matters raised. At the time of preparation of this Report those actions had not been finalised.

The risks identified in the StateNet review emphasise the important need for formalisation of responsibility and central ownership and strategy direction of the SA Government StateNet Communications Network and security of confidential government information.

Given the rapid growth of agencies and governments' use of the Internet/electronic commerce facilities and the processing and transmission of important government information via the StateNet network and shared central StateNet Gateway, ownership, management and security issues are becoming increasingly important in ensuring relevant services are available to users both within and outside of government.

Action That Needs to be Taken

Controls over the StateNet Communications Network and the shared central StateNet Gateway are critical to the protection of key government agency information within StateNet and also for internal agency networks that are connected into StateNet, particularly with regard to government agency financial transaction processing initiatives.

Audit is of the opinion that the DAIS projects and initiatives to review ownership, management and security issues for StateNet are of major importance to ensure the protection of government agency information and financial transaction systems and require priority for completion.

APPENDIX I

GLOSSARY OF TERMS

Terms and terminology used in this report.

Anti-virus	A software tool to prevent, detect and recover from infection by computer viruses.
Bizgate	One of the key e-commerce initiatives of the South Australian Government.
Demilitarised zone	A network located outside the trusted or secure network but still protected from an untrusted network, such as the internet, by a firewall gateway.
Denial of service attacks	A type of attack of a network that is designed to bring the network to its knees by flooding it with useless traffic.
e-commerce	e-commerce or electronic commerce may be defined as two or more entities' (individuals or organisations) conducting business using electronic methods and procedures.
Encryption	The conversion of data into a secret code for transmission over a public network, such as the Internet.
Firewall	A security buffer which tries to isolate and protect a network from external threats.
Gateway	A system which allows two incompatible networks to communicate.
Hacking	An attempt to gain unauthorised access to an agency's computing facilities and systems.
Internet	A world-wide electronic linking of computers. The Internet provides services such as electronic mail (e-mail), access to information stored on the linked computers and online banking, amongst many others.
Penetration testing	Used to determine whether known or assumed weaknesses can be exploited in practical operation, for example by attempts to manipulate the security mechanisms or by bypassing security mechanisms by manipulation at the operating system level.
Security patches	An actual piece of object code that is inserted into (patched into) an executable program to correct a security program defect.
Virtual private networks	A private network that is configured within a public network where data integrity and confidentiality are protected through authentication and encryption.
Web servers	A computer or device on a network that manages and accepts requests from browsers like Netscape and Internet Explorer and then returns the appropriate documents.
Web viruses	Programs that alter the way a computer works without the permission or knowledge of the user.
Wide area network.	A group of two or more computer systems linked together connected by telephone lines or radio waves.

ELECTRONIC GOVERNMENT:
LEGAL, POLICY, PRIVACY AND CONTROL:
ISSUES OF IMPORTANCE

EXECUTIVE SUMMARY

Introduction

It is important that I should restate that since 1996 Audit has reported on Information Technology developments within government agencies and made recommendations in relation to Information Technology policies and direction. In particular, in 2000 I reported on audit conclusions that there are significant operational and financial risks associated with government agencies' operations involving the use of web based e-commerce systems. I also indicated the direction that this Department would take in matters concerning electronic commerce (e-commerce) in the future.[58] Audit has now examined the various ways in which e-commerce is regulated, and of the risks to government (both legal and non-legal) associated with e-commerce activities.

The audit approach and coverage of this matter consists of two phases. Phase 1 of the review, which is addressed in this year's Report, involves three key elements:

- an overview of the regulation (both laws and government policies) governing e-commerce, with a particular focus on the regulation of Internet based systems for the communication of information and for financial transactions involving government;
- a preliminary identification, and in some respects an assessment, of the risks to government associated with such activities;
- two case studies — one on SA Central, the government's principal website, and the other concerning the operations of Bizgate, a key e-commerce initiative of the South Australian Government which is managed through the Department of Industry and Trade (DIT).

In Phase 2 of the review, which is intended to be the subject of a supplementary Report, Audit proposes to review a larger number of case studies, examining both e-commerce initiatives and the operation of websites at selected government agencies.

The objective is to consider the appropriateness of the legal, policy, privacy and control compliance framework for agencies in dealing with private sector organisations, the banking system, consumers and other agencies by way of e-commerce and/or information publishing.

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[58] Report of the Auditor-General for the year ended 30 June 2000, Part A, pp. 200-205.

Structure of this Section

As mentioned, Audit is progressing the review in two phases. The commentary immediately following relates key preliminary Audit observations and comments arising from a preliminary assessment of legal risk and outcomes and observations from two specific case study reviews and indicates the future direction of the review.

The subsequent section of the Report covers the South Australian Government legal regulatory framework for the development and operation of e-commerce and for electronic government. The commentary, in this case, is important and is designed to provide a succinct summary of information regarding the legal and regulatory requirements for this emerging area of technology as an information basis for Parliament. Further, it establishes a framework of measurement against which this first phase audit review and subsequent audit reviews can be assessed. Also, in developing the commentary, Audit has identified certain risks which need to be addressed; some initial thoughts on the assessment of these risks is provided.

The final part of this section includes some preliminary observations concerning risk and observations and comments arising from the two case studies.

Key Preliminary Audit Observations and Comments

Preliminary Assessment of Legal Risk

The preliminary review of the legal framework has identified some risks which need to be further examined by Audit. Those risks will be addressed in Phase 2 of the review process. Some of the risks identified were evident in the case study examples reviewed, and certain risks were identified from other sources. Broadly, they fall into the categories of, contracting risk, inappropriate or unlawful content risk, and information management and security risk.

Case Study Outcome — SA Central

SA Central is the Department for Administrative and Information Services (DAIS) managed website which supplies information and links to other websites to business and members of the public over the Internet.[59] It is intended to be the first and main point of contact for anyone seeking information as to the State or as to a variety of government and private services offered within it.

The preliminary review found that the SA Central website was well presented and had the legal features (disclaimers, privacy statement, copyright statement and statement of trade mark ownership) that would be expected of a good website. The review identified some aspects which may be further improved and certain matters which require further investigation.

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59 www.sacentral.sa.gov.au.

Matters which could be further improved included the sufficient notice of the website disclaimer and its use by certain government agencies where reliance is placed on information held on the agency website.

Audit will be exploring certain aspects of the SA Central website and other agency website locations in Phase 2 of the review process.

Case Study Outcome — Bizgate

Bizgate is a significant e-commerce initiative of the South Australian Government managed through the Department of Industry and Trade (DIT). Bizgate provides a diverse range of e-commerce services to over 30 government and local government organisations including the provision of online forms and payment services.[60]

The review highlighted some important observations which need to be addressed by DIT. These related to the areas of policy and management arrangements, contract and service level agreements, continuity of operations, system changes, and intellectual property rights. Some of the more salient observations follow.

The original project was developed in an incremental fashion and has evolved and developed into a significant e-commerce activity. However, important matters relating to policy, management reporting, and control arrangements had not changed markedly from the informal arrangements that applied in the early development stages.

There were a number of client agencies without formal agreements with Bizgate, and limited detail on important matters such as service levels, continuity of operations, intellectual property rights, and required security controls in those agreements that had been documented.

In addition, ownership of intellectual property has again emerged as an issue for a government agency.

The Department has advised of actions taken to address the matters raised by Audit.

Conclusion and the Way Forward

This current Audit review has identified a number of matters which need to be further examined. Audit intends to further relate on these matters with the agencies concerned as part of its ongoing review of government e-commerce developments and initiatives.

Phase 2 of the review will examine a larger range of agency case studies to assess the status of developments in electronic government and the measures taken by government and agencies to mitigate the risks identified in this Report.

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60 www.bizgate.sa.gov.au.

SOUTH AUSTRALIAN GOVERNMENT LEGAL REGULATORY FRAMEWORK

The major forms of legal regulation potentially applicable to e-commerce are considered below under the following broad headings:

- laws directly concerned with transactions and financial arrangements;
- laws which impose liability in relation to the nature or quality of information (content) uploaded onto websites, contained in e-mails or otherwise made available through electronic means;
- rights provided to those who are the subject of information obtained or stored electronically;
- other laws regulating the management of such information;
- intellectual property rights arising out of or associated with electronic transactions, websites and e-commerce processes;
- laws which prohibit discrimination in relation to access to Internet facilities;
- criminal offences specifically associated with computers and information technology.

In addition, commentary on Government Policy and standards is made in context of this regulatory framework.

Throughout the following material the laws relevant to South Australian Government agencies are discussed. They include common law and South Australian legislation, though Commonwealth legislation has also been discussed where relevant. Many business users of Internet services provided by South Australian Government agencies may be subject to Commonwealth legislation, even if the agencies themselves are not. Moreover the agencies, when entering into agreements with the Commonwealth for funding or other co-operative arrangements, may undertake to comply with Commonwealth laws and policy.[61]

It should be noted that the view adopted by Australian governments is that the phenomenon of e-commerce does not, in general, demand special forms of regulation. As one federal government policy document puts it:[62]

'The Attorney-General has consistently stated that the legal issues raised by e-commerce are not so novel that an entirely new body of law is required to deal with them. It is the Government's view that our legal system is, subject to some minor adjustments, generally capable of dealing with (the) issues …'.

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61 For instance, one contract of this kind that Audit has reviewed specifically refers to the *Privacy Act 1988* (Commonwealth), the *Crimes Act 1914* (Commonwealth), the *Racial Discrimination Act 1975* (Commonwealth), the *Sex Discrimination Act 1984* (Commonwealth) and the *Disability Discrimination Act 1992* (Commonwealth).

62 An Australian Legal Framework for Electronic Commerce: Issues Paper, 1998: (http://law.gov.au/publications/ecommerce/issues_11_98.html).

‘Business and consumer confidence will be encouraged by setting a light-handed regulatory framework to support the private sector led development of e-commerce …’.

On this view, existing forms of regulation are generally regarded as needing no more than modest adjustments to cope with the new environments for commerce and communications. Moreover, it is seen as preferable that emerging problems (such as guaranteeing the security of online payments) should as far as possible be addressed by voluntary practices and standards adopted by the business sector.

This is not to say that no modifications at all have been needed. The Electronic Transactions Acts and the ‘digital agenda’ amendments to copyright law, both considered in the sections that follow, are just two examples of legislative initiatives seen as being essential if certain forms of regulation were to keep pace with the emergence of electronic communication and digital storage of information. However these initiatives remain the exception rather than the norm, so that by and large e-commerce is being regulated by laws that pre-date its emergence.

Transactions and Financial Arrangements

Contract Law

Agreements entered into by electronic means are as much subject to the law of contract as their counterparts in the paper-based world. Thus the ordinary common law rules as to the formation, interpretation and enforcement of contracts will apply, together with the various statutory provisions that cover different types of transaction.[63]

Although most of these rules can be applied to electronic transactions in a straightforward and uncontroversial manner, there are exceptions. Certain kinds of electronic transaction, such as those relating to online gambling, have been perceived by government to demand specific regulation.[64] At a more general level, the problematic issue of satisfying statutory formalities (such as recording a contract ‘in writing’, or ensuring that a contract has been ‘signed’) has been addressed by the Electronic Transactions Acts which are discussed separately below. However there remain other areas of potential difficulty or uncertainty not dealt with (either fully or at all) by that legislation.

One concerns the place and time at which a contract entered into by means of electronic communications is formally concluded. Where the parties are located in different States or even different countries, this may have considerable significance for questions of jurisdiction: that is, which laws apply, and where any disputes can or should be resolved. If for instance an offer to supply goods or services is accepted by e-mail, is the contract concluded when and where the e-mail is sent, or when and where it is received? The general assumption

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63 See eg *Sale of Goods Act 1895* (SA); *Law of Property Act 1936* (SA); *Insurance Contracts Act 1984* (Commonwealth).

64 See Interactive *Gambling Act 2001* (Commonwealth).

among legal commentators seems to be the latter, but the point is yet to be definitively resolved.[65]

A further question concerns the status or effectiveness of ‘click-wrap’ or ‘web-wrap’ agreements. These are agreements formed entirely in an online environment such as the Internet, which sets forth the rights and obligations between parties. A business or agency may indicate its willingness to enter into a contract to supply goods or services on the basis of terms and conditions that are set out on a website. If the customer performs a mouse-click to indicate their acceptance of such conditions, does that necessarily mean that they are incorporated into any resulting agreement? The answer probably depends on whether the customer has received ‘reasonable notice’ of the conditions — but again whether that is correct, and if it is what exactly would constitute reasonable notice, are matters that await judicial attention in Australia.[66]

Finally, it should be noted that even where the rules applicable to an electronic transaction are clear, there may be considerable practical difficulty in enforcing them against parties who are outside the jurisdiction. This is a particular concern in terms of the effectiveness of consumer protection laws, as they might apply to foreign suppliers of goods or services.[67]

Electronic Transactions Legislation

The *Electronic Transactions Act 1999* (Commonwealth), which came into operation on 15 March 2000, was introduced originally at Commonwealth level and has been mirrored or enacted in substantially similar form in each State of Australia.[68] ***The South Australian version, the Electronic Transactions Act 2000 (South Australia), has not yet come into operation and will not until appropriate regulations have been prepared.***

The principal aim of the legislation, as already mentioned, is to overcome potential problems with satisfying statutory formalities that were drafted in an age of paper-based communications. The Acts are based on the principles of functional equivalence and technological neutrality. The former seeks to ensure that the performance of any action or the discharge of any obligation may occur in an electronic environment and carry the same weight as if it had been performed in any other environment. The latter dictates that legislation should be carefully drafted so that it is not restricted to any particular types of technology, whether currently known or not.

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65 See eg S Hill, ‘Flogging A Dead Horse — The Postal Acceptance Rule and Email’ (2001) 17 Journal of Contract Law 151.

66 See further C Tay, ‘Contracts, Technology and Electronic Commerce: The Evolution Continues’ (1998) 9 Journal of Law and Information Science 177 at 185-198, reviewing US case law on this point.

67 For a European perspective on this issue, see N Reich, ‘Consumerism and Citizenship in the Information Society — The Case of Electronic Contracting’ (2000) 7 Competition and Consumer Law Journal 185.

68 The legislation is based on the Model Law on Electronic Commerce 1996 adopted by the United Nations Commission on International Trade Law (UNCITRAL). For background, see A Upcroft, ‘E-Commerce: Global or Local? An Australian Case Study’ (1999) 10 Journal of Law and Information Science 113; and see also Electronic Commerce Expert Group, ‘Electronic Commerce: Building the Legal Framework’, Report to the Attorney General, 1998 (http://law.gov.au/aghome/advisory/eceg/ecegreport.html).

Specifically, the Acts deal with federal and state requirements that information be given in writing, that a signature be provided, that a document be produced or retained or that information be recorded. Rather than amend each and every one of the statutory provisions in question, the Acts provide that as a general rule such requirements may be met or carried out electronically, subject to appropriate safeguards being observed for the protection and integrity of any data.

The Acts also set out certain rules that, in the absence of any agreement between parties to the contrary, will identify when and where electronic communications are to be taken to have been sent and received.

As from 1 July 2001, the Commonwealth Act applies to all dealings with and by a Commonwealth agency, other than those specifically exempted from the operation of the Act by the regulations. The South Australian Act, when proclaimed, will likewise apply to all dealings with South Australian Government agencies, subject to any exceptions provided in the regulations.

Parallel to this legislation is the work of a Joint Departmental Group led by the Information Economy Policy Office working towards the establishment of best practice approaches and compatible standards.

Electronic Funds Transfer

Electronic funds transfer is regulated by a wide range of mechanisms including the contracts between an account or card holder and the financial institution, the account/card holder and the merchant, the merchant and the financial institution, and between institutions. Many of these contracts, if not all, are subject to the provisions of the *Trade Practices Act 1974* (Commonwealth) that are considered separately below. There is also the Electronic Funds Transfer Code of Conduct, a document negotiated between financial institutions, consumer groups, government and interested regulators, including the Australian Competition and Consumer Commission (ACCC). The Code is typically given legal effect by incorporation into the contract between account/card holders and financial institutions. Financial institutions will also be subject to various finance industry codes of conduct, including the Code of Banking Practice, Building Society Code of Practice and the Credit Union Code of Conduct.

Statutes providing for offences for interfering with online financial communications include the *Telecommunications Interception Act 1979* (Commonwealth), the *Crimes Act 1914* (Commonwealth) and the *Radio Communications Act 1992* (Commonwealth). The *Privacy Act 1988* (Commonwealth) is also relevant, as discussed later on.

The Australian Prudential Regulation Authority (APRA) is the industry body responsible for the establishment and enforcement of prudential standards and practices. APRA is the sole regulatory authority in relation to prudential matters by virtue of the *Financial Transactions Reports (South Australia) Act 1999* (South Australia).

Taxation

The e-commerce environment poses jurisdictional difficulties in respect of many forms of taxation. By facilitating commercial transactions across national boundaries, the Internet may make it hard in some cases to ascertain taxpayer identity and/or the location of the jurisdiction where products or transactions occur. As such, e-commerce can pose some implications for the tax bases of governments. ***For State Governments in particular, it has the potential to have a considerable impact on the amount of revenue raised from stamp duty and other transactional based taxes.***

The issue of loss of revenue arises by virtue of the fact that State revenue raising is performed on a jurisdictional basis. In electronic transactions it is more difficult to identify the jurisdiction and more likely that there will be a conflict between jurisdictions, or that State law will simply not have sufficient nexus to the transaction to apply. In the absence of a clear nexus, the state government may not be able to obtain the revenue from that transaction.

Content Liability

Those who disseminate information by electronic means, for instance by sending e-mails or putting content on a website, or by providing facilities which allow others to do so, run the risk of incurring liability under a wide range of laws. Some of these laws are set out in the text that follows, while others (including privacy legislation and intellectual property laws) are dealt with later on in this section of my Report.

Negligent Misstatement

The common law of negligence in certain cases requires care to be taken to ensure that a statement is accurate, or that it is not misleading without further material also being provided. Where a duty of care is breached, a person to whom that duty is owed may recover damages in tort to compensate them for any loss they have foreseeably suffered.[69]

Importantly, however, the common law does not impose a duty of care in all situations in which information is communicated. Generally speaking, a duty will only arise in cases where it would be reasonable for the plaintiff to rely on the truth or accuracy of the defendant's statement, and the defendant is aware, or ought to be aware, that the statement will be relied upon by a specific individual or someone from an ascertainable class. In most cases in which a duty is imposed, the parties have some kind of established relationship. In such cases the information provider may have assumed responsibility for the accuracy of the information.

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69 See eg *L Shaddock & Associates Pty Ltd v Parramatta City Council* (1981) 150 CLR 225. For a discussion of government liability for the misstatement of information, see W D Duncan, 'Reliance upon Government Information — Select Issues' in B Horrigan (ed), 'Government Law and Policy: Commercial Aspects', Federation Press, 1998. See also S Kneebone, 'Tort Liability of Public Authorities', LBC Information Services, 1998.

It is possible for liability to arise outside such situations, even for information voluntarily provided, but the courts are wary of creating indeterminate liability for negligent misstatements.[70] A person or organisation that included misleading or incorrect information on their website, for instance, would be unlikely to owe a duty of care to every person who viewed or could be expected to view that information.[71] It is possible in any event to negate any reliance on the accuracy of particular advice or information, and thus avoid potential liability, by the use of an appropriately worded disclaimer.[72]

Trade Practices and Fair Trading Legislation

The *Trade Practices Act 1974* (TPA) applies to the activities of trading, financial and foreign corporations, and also to any business of the Commonwealth, whether carried on by the Crown in right of the Commonwealth or by a Commonwealth authority.[73]

The Act includes provisions relating to restrictive trade practices (Part IV), unconscionable conduct in relation to the supply of goods or services (Part IVA), price exploitation in relation to the New Tax System introduced in 2000 (Part VB), and anti-competitive conduct and record-keeping rules in relation to the telecommunications industry (Part XIB).

However the provisions of most relevance in the present context are the consumer protection provisions in Part V. Those provisions are mirrored in the *Fair Trading Act 1987* (SA) (FTA). The FTA applies in relation to transactions that take place wholly or in part in South Australia and is expressed to bind the Crown to the fullest extent possible under State legislation. It also governs the conduct of individual persons as well as corporations.

Both the TPA and the FTA provide that a person/corporation must not, in trade or commerce, engage in conduct which is misleading or deceptive or is likely to mislead or deceive. ***These provisions are plainly capable of being breached by government agencies engaged in e-commerce, at least to the extent that their activities can be said to occur 'in trade or commerce'.[74] While it is unlikely that purely internal communications (including e-mails) could attract liability, incorrect information provided on a website in connection with some form of trading or commercial activity might well be caught.***

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70 See eg *Esanda Finance Corp Ltd v Peat Marwick Hungerfords* (1997) 188 CLR 241 (auditor not liable to financial institution which loaned money to a company on the faith of the auditor's report). For a recent discussion of this area of the law see S Warne, 'Legal Professional Liability — Part 1' (2000) 8 Torts Law Journal 283.

71 Though they might still incur liability under the misleading and deceptive conduct provisions considered in the next section.

72 See eg *Hedley Byrne & Co v Heller & Partners Ltd* (1964) AC 465. The disclaimer must however be unambiguous: see eg *Burke v Forbes Shire Council* (1987) Aust Torts Reps 1; *Mid Density Developments Pty Ltd v Rockdale Municipal Council* (1993) 44 FCR 290.

73 Some provisions also apply to the States and their agencies, but the consumer protection provisions in Part V are not among them: section 2B.

74 Cf *E v Australian Red Cross Society* (1991) 27 FCR 310; *Mid Density Developments Pty Ltd v Rockdale Municipal Council* (1992) 39 FCR 579; *Sykes v Reserve Bank of Australia* (1999) ATPR 41-699.

When considering whether conduct is misleading or deceptive, the conduct is considered in all its surrounding circumstances as to whether it conveys a misrepresentation. It is not relevant that the conduct was not intentionally misleading or deceptive.

While an appropriately worded disclaimer can avoid liability for misleading or deceptive conduct,[75] this will be so only where the disclaimer actually prevents the plaintiff from being deceived. It is not possible simply to contract out of such liability.[76] Hence a disclaimer on a website, for instance, will only be effective to the extent that users can reasonably be expected actually to read it and appreciate that they are not to rely on the accuracy of particular information on the site.

The TPA and the FTA also prohibit particular kinds of representation in respect of the supply or use of goods or services. These include falsely representing that goods or services have a particular standard, quality or value, or that they have a sponsorship or approval which they do not have.

In general, there is no requirement that any action that finds liability under this legislation be deliberate. The action may be completely inadvertent or innocent. Penalties for engaging in misleading or deceptive conduct include damages and corrective advertising. Injunctive relief is also available to a plaintiff.

The ACCC is the Commonwealth statutory authority responsible for administering the TPA. The ACCC may bring enforcement actions against infringers in its own right or assist consumers to bring their own actions.

The South Australian Office of Consumer and Business Affairs (OCBA) provides assistance to consumers in resolving disputes with merchants or service providers. Unlike the ACCC, however, OCBA has no statutory enforcement role.

Broadcasting Services Legislation

The *Broadcasting Services Act 1992* (Commonwealth) is the Act which governs all broadcasts, whether by radio or television or any other form of media. Broadcasts are defined to be (amongst other things) transmissions from a point to a multi-point. Expressly excluded from the definition are services which provide no more than data (with or without still images), as well as a service which makes programs available on demand on a point-to-point basis.

It is possible, through the use of technology, to broadcast over the Internet. To the extent that the activity performed is a broadcast, the activity is regulated by the Act. If the activity is not a broadcast, it may be regulated under the *Telecommunications Act 1997*

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75 See eg *Keen Mar Corp Pty Ltd v Labrador Park Shopping Centre Pty Ltd* (1989) ATPR (Digest) 46-048.

76 *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd (*1988) 79 ALR 83.

(Commonwealth) or the *Radio Communications Act 1992* (Commonwealth), depending on the technology being used.

The Broadcasting Act provides for a licensing scheme for licensing of broadcasting activities. There are different classes of licence and different conditions attaching to each licence. The Australian Broadcasting Authority (ABA) has responsibility for licensing and enforcement issues.

Censorship of Internet Content

Schedule 5 of the *Broadcasting Services Act 1992* also regulates Internet content in Australia. It provides for a complaints mechanism for persons to complain to the ABA about persons in Australia accessing prohibited content or potential prohibited content.

Prohibited content is content classified by the Classifications Board under the *Classification (Publications, Films and Computer Games) Act 1995* (Commonwealth) as RC (refused classification) or X. Potential prohibited content is material which has not been classified but is substantially likely to consist of prohibited material.

If Internet content is determined to be prohibited content by the ABA, the ABA must give the Internet content host an order to remove it. If the Internet content is hosted outside Australia, an order to take all reasonable steps to prevent public access to such material will be given to each Internet service provider known to the ABA.

There is provision for industries to establish codes of practice under Part 5 of Schedule 5 of the *Broadcasting Services Act 1992*. Industry codes may be approved by and registered with the ABA. Industry compliance with the codes is voluntary unless the ABA has ordered compliance. The Internet Industry Association has had such a code registered. It covers the provision of relevant information to consumers about complaints and access to filtering technology, notification of relevant laws applying to Internet content and reporting mechanisms.

The Classifications (Publications, Films and Computer Games) (Miscellaneous) Amendment Bill 2000 is currently before the South Australian Parliament. The Bill is based on Schedule 5 of the *Broadcasting Services Act 1992* (Commonwealth), though it seeks to complement the federal statute by covering persons who place content on the Internet rather than the hosts who supply the means to do so. It applies to material which is in stored form and accessible using an Internet carriage service. It provides for offences if a person knows the content is objectionable or unsuitable or the person is reckless as to the nature of the material.

Vilification and Harassment Laws

Section 37 of the *Wrongs Act 1936* (SA) defines an ‘act of racial victimisation’ and provides that such an act that results in detriment (also defined) is actionable as a tort by the person who suffers the detriment. Any compensation for victimisation must take into account any damages awarded by a court in proceedings under the *Racial Vilification Act 1996* (SA). The latter provides that it is an offence to incite hatred towards, serious contempt for, or severe ridicule of a person or group of persons on the grounds of race. Racial vilification is also proscribed under the *Racial Discrimination Act 1975* (Commonwealth).

Both the* Equal Opportunity Act 1984 *(South Australia) and the* Sex Discrimination Act 1984 *(Commonwealth) prohibit sexual harassment. This is defined broadly enough to cover, for example, sexually explicit e-mails, where it could reasonably have been anticipated that the recipient would be offended, humiliated or intimidated.

Rights of Information Subjects

Defamation

Defamation is the communication by one person to another of matter (words, pictures or other material) which adversely affects the reputation of a third person, or which causes the third person to be shunned or avoided, in circumstances where there is no proper defence.[77] In South Australia, the common law action for defamation is modified by the operation of Part I of the *Wrongs Act 1936*, which provides for criminal penalties for defamation in some circumstances.

In the case of libel (that is, publication of defamatory material), damage need not be shown. It is sufficient that a reasonable person would tend to think less of the defamed person. There need be no evidence that this has actually happened.

Truth is a complete defence to libel in South Australia. Furthermore, where a person is under a duty (whether legal or moral) to speak out or give advice on a matter, they will not be liable for defamation, provided the statement in question was true, not uttered in malice and only published to a person with a legitimate interest in receiving the statement.

Defamation occurs in the place of publication. It has recently been held by the Supreme Court of Victoria that an article available by subscription over the Internet is published in the place where the article is accessed (by being downloaded onto the reader's computer), not the location where the article is stored on a server.[78] ***It is therefore important that information published on the Internet is not defamatory of any person under the law of any jurisdiction where the information may be accessed — which in the case of information on a publicly accessible website may be anywhere in the world.***

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77 J McLachlan and P Mallam, 'Media Law & Practice', Law Book Co, 1995, paragraph 9.70.

78 'Gutnick v Dow Jones & Co Inc' (2001) VSC 305 (28 August 2001).

Privacy and Data Protection

The *Privacy Act 1988* (Commonwealth) sets out certain privacy principles which reflect Australia's international obligations in relation to providing for the privacy of individuals. The Act is expressed to bind all the States and Territories of Australia but does not have operation over State governments or agencies or State banking except where State boundaries are crossed. Commonwealth government agencies are required to comply with the Act, which from 21 December 2001 will also apply to most larger businesses in the private sector.[79]

The National Privacy Principles (NPPs) in the Act contain rules for the collection, storage, use, disclosure, accuracy and security of personal information, access to personal information, issues of anonymity and data flow, and special provisions in relation to 'sensitive' information (information as to a person's race, political, religious or philosophical beliefs, trade/industry membership, sexual preference, criminal record and health). NPPs apply only to the private sector. A further set of Information Privacy Principles (IPPs), also contained in the Act, apply to the Commonwealth public sector and are less stringent in terms of requirements than the NPPs.

The Act provides for complaints to be made to the Australian Privacy Commissioner. Complaints may be in relation to interferences with the privacy of an individual or about an act or practice of an organisation which is bound by an approved code. The Commissioner may carry out an investigation into the complaint, the outcome of which may be a formal determination. The Commissioner may include in the determination a declaration that acts should be performed to redress loss or damage, or that compensation should be paid to the complainant. A declaration by the Commissioner is not directly binding on the parties, but proceedings to enforce it can be brought in the Federal Court or the Federal Magistrates Court. The court will conduct a hearing de novo to determine whether the conduct complained of occurred.

The Act also contains provisions relating to tax file numbers and credit information. As interstate banking and income tax (to which tax file numbers relate) are matters under Commonwealth jurisdiction, State Government agencies are effectively bound by these provisions.

South Australia does not have comprehensive privacy legislation. State Government agencies are required to comply with a Cabinet instruction which includes the fundamental features of the IPPs in the 1988 Commonwealth Act,[80] though the instruction is expressed in more general terms than either the IPPs or the new NPPs. For example, it contains a

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79 *Privacy Amendment (Private Sector) Act 2000* (Commonwealth). For a discussion of privacy issues and Commonwealth Government Internet use see Australian National Audit Office Better Practice Guide, 'Internet Delivery Decisions', 2001, Part 8 'Privacy Issues, the Internet and the Government Manager' (www.anao.gov.au); and see also the Guidelines for Federal and ACT Government World Wide Websites issued by the Privacy Commissioner, available at www.privacy.gov.au/issues/p7_2.html.

80 South Australian Government Administrative Instruction No 1 of 1989, located at: www.archives.sa.gov.au/services/public/privacy_index.html.

prohibition on the 'misuse' of information, where the IPPs and the NPPs state there must be no unauthorised 'access, modification or disclosure' (NPP 4.1, IPP 4(a)). The NPPs also have a requirement that information no longer needed must be destroyed (NPP 4.2).

Access to information under the Cabinet instruction is also limited to access via freedom of information requests (which are considered below). Both the NPPs and the IPPs have more general access provisions and specifically allow individuals to request amendments to information to correct errors or inaccuracies (NPP 6.5, IPP 7(3)). The Cabinet instruction merely has a general provision that the agency holding the record should correct it so far as it is inaccurate.

The NPPs also have provisions relating to transborder data flow (NPP 9), a prohibition on the adoption of identifiers attached to records (NPP 7) and provisions permitting anonymity in transacting with an agency (NPP 8). These are not replicated in the IPPs.

The Cabinet instruction established the Privacy Committee of South Australia in order to oversee compliance by agencies. The Committee may conduct investigations and make recommendations in relation to the implementation of the Cabinet instruction by agencies. The Committee will also forward complaints received from the public to the appropriate authorities for dealing with that complaint.

In addition to the rights provided under the 1988 Commonwealth Act, freedom of information legislation at both federal and State level grants information subjects certain rights in relation to personal and business information held by government agencies.[81] Freedom of information operates upon the basis that every person has a legally enforceable right to obtain access to government documents unless an exemption applies. Documents that may be claimed to be exempt include those affecting personal privacy, business affairs and material obtained in confidence. These exemptions do not prevent access by information subjects to their own records. In cases where information affecting the business affairs or personal privacy of someone other than the applicant is sought, the information subject must be consulted. Freedom of information legislation also provides for the amendment or annotation of personal records when the information subject believes that the information is incomplete or incorrect.

Privacy is also dealt with in a piecemeal fashion across a variety of other South Australian statutes, including the *Births, Deaths and Marriages Registration Act 1996*, the *Road Transport (Alcohol and Drugs) Act 1977*, the *Supported Residential Facilities Act 1992* and the *Ombudsman Act 1972*. These Acts all contain provisions relating to privacy and/or personal information.

It is also possible in certain cases for a data subject to protect their privacy by invoking the common law doctrine of breach of confidence.[82] The common law applies to all persons, including the South Australian Government and its agencies. A duty of confidence applies in

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[81] *Freedom of Information Act 1982* (Commonwealth); *Freedom of Information Act 1991* (South Australia).

[82] See J McKeough and A Stewart,' Intellectual Property in Australia', 2nd edition, Butterworths, Sydney, 1997, Chapters 3-4.

relation to information which is not known to the public and which is either agreed to be confidential or received in circumstances that a reasonable person would understand to import a requirement of confidentiality. If personal information is disclosed in confidence by an individual, and then misused or disclosed without their consent, they may seek an injunction to restrain the breach of confidence, and/or seek damages for any loss they have suffered.[83]

Information Management

Freedom of Information and Archives

Freedom of information has been discussed above in relation to the rights of information subjects. Freedom of information should also be considered in relation to information management and the control of electronic government records. Under Commonwealth and State legislation a 'document' is defined to include not only paper based material but information stored electronically.[84] ***Government obligations of disclosure and publication under this legislation must therefore be considered in relation to electronic information.***

Similarly, archives legislation needs to be considered in relation to the management of government information stored in electronic form. 'Record' is defined under this legislation to include not only written or printed documents, but other objects from which information may be reproduced.[85]

Legal Deposit of Published Works

Publishers of material published in South Australia have legal deposit obligations to the State and Parliamentary libraries[86] and the National Library.[87] Publications that must be supplied to the National Library are confined to 'library material' in which copyright subsists. 'Library material' is defined to mean a 'book, periodical, newspaper, pamphlet, sheet of letter-press, sheet of music, map, plan, chart or table'.[88] The Copyright Law Review Committee has recommended that the relevant legislation be amended so that legal deposit obligations extend to material stored in electronic form.[89] Under the South Australian legislation the material to be delivered includes, in addition to the materials mentioned

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83 As to the application of the doctrine of breach of confidence to personal information, see eg *Douglas v Hello! Ltd* (2001) 2 WLR 992. Note however that the Australian common law does not recognise a right of privacy as such: *Cruise v Southdown Press Pty Ltd* (1993) 26 IPR 125.

84 See the definitions of 'document' in *Freedom of Information Act 1982* (Commonwealth) section 4; *Freedom of Information Act 1991* (South Australia) section 4.

85 *Archives Act 1983* (Commonwealth) section 3; *State Records Act 1997* (South Australia) section 3.

86 *Libraries Act 1982* (South Australia) section 35.

87 *Copyright Act 1968* (Commonwealth) section 201.

88 ibid.

89 Copyright Law Review Committee, *Simplification of the Copyright Act 1968*: Part 2 Categorisation of Subject Matter and Exclusive Rights, and Other Issues, 1999, paragraph 7.125.

above, films, audio tapes, discs and 'other item(s) made available to the public, defined to store and facilitate the reproduction of visual images, sound or information'.[90] This extends to information in electronic form at least when stored in a physical object that is made available to the public such as a CD ROM. ***However, neither of the relevant statutes cover information published on the Internet.***

Intellectual Property

I have included overviews of the legal environment for the protection of intellectual property in three previous reports.[91] These reports provide information on the protection given by the general law to confidential information, and on the broad range of intellectual property rights available under Commonwealth legislation such as the *Patents Act 1990* and *Copyright Act 1968*. In the 1998-99 Report, I discussed copyright in computer software in some detail.[92] With those accounts as a background, it is necessary for the purposes of this review to look at intellectual property issues relating specifically to the supply of South Australian Government services and information on the Internet.

Copyright and Moral Rights

Copyright is one of the regimes of intellectual property that plays a major role in regulation of content on the Internet. In Australia, copyright is governed by the *Copyright Act 1968* (Commonwealth). Rights also extend to most jurisdictions throughout the world through the operation of international treaties administered by the World Intellectual Property Organisation (WIPO) and the World Trade Organisation (WTO).

The *Copyright Act 1968* (Commonwealth) protects the following categories of material: literary works (including computer software); dramatic works; musical works; artistic works; sound recordings; films; broadcasts; and published editions. These are protected once stored in a material form, which may include electronic storage. Material on the Internet that may be protected by copyright includes text, music, computer programs, photographs, graphics, sound recordings, and film.[93]

Owners of copyright are granted a series of exclusive rights which enable them to control the use of protected material and derive income from it. These exclusive rights include the right to reproduce, publish, adapt, and perform in public. In 2001 a new right was introduced: the

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90 *Libraries Act 1982* (South Australia) section 35.

91 Report of the Auditor-General for the year ended 30 June 1997, Part A.3, p. 47; Report of the Auditor-General for the year ended 30 June 1998, Part A.4, p. 65; Report of the Auditor-General for the year ended 30 June 1999, Supplementary Report: Intellectual Property Management, pp. 22-28.

92 Report of the Auditor-General for the year ended 30 June 1999, Supplementary Report: Intellectual Property Management.

93 For the a discussion of subsistence, duration, and ownership of copyright, see Report of the Auditor-General for the year ended 30 June 1999, Supplementary Report: Intellectual Property Management, pp. 24-26.

right to communicate a work to the public.[94] 'Communicate' means 'make available online or electronically transmit' and so is directly relevant to use of material on the Internet.

The reproduction right must also be considered when using the Internet, since storage in an electronic form constitutes a reproduction. Transmission of material over the Internet may indeed involve multiple reproductions. In the recent amendments to the Act an exception to infringement was introduced which provides that it is not an infringement if temporary reproductions are made as part of the technical process of making or receiving a non-infringing communication.

A range of other amendments relevant to the digital environment were also introduced in the provisions that commenced in 2001. These included a new right of action by copyright owners against people who import or manufacture devices, or provide services, that facilitate the circumvention of technological protection measures such as locks or encryption. Removal or alteration of electronic rights management information (which identifies the author or owner or states the conditions of use) without the permission of the owner may also give rise to a right of action.

When a person wishes to use copyright protected material in any of the ways exclusively controlled by the owner they must ensure that they have permission. This permission is usually provided in the form of a licence, which may be expressly granted or implied from the owner's conduct or the circumstances in which the material has been developed or communicated.

The *Copyright Act 1968* (Commonwealth) includes some limited exceptions which allow certain uses without the need to obtain a licence. For instance, fair dealings for purposes such as research and study or criticism and review may be allowed. Special provisions also allow use of copyright material for the services of Commonwealth or State Government agencies. However, when material is used by government in reliance upon this exception the Commonwealth or State must contact the owner as soon as possible and agree on terms.[95]

Another recent reform of Australian copyright law is the introduction of 'moral rights'.[96] The new provisions introduce the following rights: a right of attribution of authorship; a right not to have authorship falsely attributed; and a right of integrity of authorship. These rights are granted to authors and may be exercised by them even though the copyright is owned by another.

This is a significant point to emphasise in relation to copyright owned by government. Although the *Copyright Act 1968* (Commonwealth) grants the Crown special rights in relation

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94 This replaced the old broadcast and diffusion service rights, under amendments introduced by the *Copyright Amendment (Digital Agenda) Act 2000* (Commonwealth).

95 Where agreement cannot be reached, the Copyright Tribunal may fix the terms of the use.

96 *Copyright Amendment (Moral Rights) Act 2000* (Commonwealth).

to ownership,[97] authors of Crown copyright works may still exercise their rights to be attributed as authors, and to object to derogatory treatment of their work that is prejudicial to their honour or reputation. These rights are personal to the author and may not be assigned or waived. Authors may however consent to certain treatments of their work, and in some cases a defence may be raised that the act was reasonable in the circumstances.

Patents

A patent grants certain exclusive rights of exploitation over a new invention. In Australia, the registration of patents is governed by the *Patents Act 1990* and administered by IP Australia (Patent Office). A standard patent generally lasts for 20 years. Recent amendments to patent law in Australia have introduced 'innovation patents'.[98] These patents provide protection for small scale innovations, they have a shorter protection period (eight years), and the registration process is simpler than for standard patents.

It may be possible in some circumstances for new products or processes associated with e-commerce and Internet communication to be patented. If valid (and the criteria for patentability in Australia are fairly stringent), such patents may significantly constrain e-commerce initiatives, by requiring those who wish to market a product or use a process which is similar to that patented to pay a licence fee for their use. Particular controversy has attached to attempts to secure patents both for new computer software and for innovative 'business processes'.[99] ***It is understood that many of the initial applications for the new innovation patents are for e-commerce related business processes. This suggests that the issue is likely to come before the courts in the near future as attempts are made both to enforce and challenge the validity of such patents.***

Confidential Information

As already mentioned, the common law protects information when the relevant parties agree that it is confidential, or when the information is provided in circumstances that could reasonably be inferred to be confidential. This includes commercially valuable information such as 'trade secrets' and personal information which an individual wishes to keep private. So long as this information remains secret, its use or disclosure without the permission of the person or organisation to whom the information 'belongs' will constitute an actionable breach of confidence.

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97 See discussion in: Report of the Auditor-General for the year ended 30 June 1997, Part A. 3, pp. 47-48; Report of the Auditor-General for the year ended 30 June 1998, Part A. 4, p. 66; Report of the Auditor-General for the year ended 30 June 1999, Supplementary Report: Intellectual Property Management, p. 25.

98 *Patents Amendment (Innovation Patents) Act 2000*.

99 See G Middleton, 'Internet Patents' (1999) 10 Journal of Law & Information Science 153; R N McFarlane, 'Business Process Patents' (2000) 13 Australian Intellectual Property Bulletin 38.

Uploading material onto the Internet will constitute a disclosure, and so persons responsible for the content of websites must ensure that any material made available on the Internet is not confidential.[100]

It is important to appreciate that a duty of confidentiality may be breached by accidental as well as deliberate disclosure.[101] Clearly therefore the mistaken uploading of sensitive information onto a website or the misdirection of an e-mail message could result in liability.

Indeed this point could conceivably be taken much further. Many systems for the electronic storage or communication of information are not secure, in that they are capable of being quite easily 'hacked into' by those with the necessary technical know-how. Does this imply, for instance, that communicating confidential information in ***an ordinary e-mail over an open network might be regarded as a negligent disclosure to any hackers that might take the trouble to access the information — even though the e-mail was being sent to someone with a perfectly legitimate interest in receiving the information?*** Would all e-mails containing sensitive information require some form of encryption to escape the risk of such liability? Such a view might seem quite impractical, but until tested in court it cannot be discounted.

In some instances an unauthorised disclosure of confidential information may be justified on the ground that publication is in the public interest, although the facts of a particular case would need to be carefully considered before this defence were relied upon.[102]

Trade Marks, Passing off and Domain Name Registration

Trade marks are used by traders to identify goods or services as their own. When combined with advertising, companies use trade marks to build up brand name loyalty amongst consumers. In turn, consumers use trade marks for product information: as an assurance of the origins, and perhaps the quality, of goods and services. In Australia, trade marks can be registered in relation to specified goods or services under the *Trade Marks Act 1995* (Commonwealth). A registered mark is infringed if it is used as a mark in relation to the same or similar goods or services.

The tort of passing off may also provide traders with some protection against rival traders who seek to cash in on their established reputation in the market place. The tort encompasses any conduct which might be taken to suggest a connection with another trader that does not in fact exist, whether the misrepresentation was intended or not. In practice, actions for passing off are usually brought in conjunction with actions for misleading or deceptive conduct under the TPA or FTA.

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[100] 'It is clear that once material is accessible through the internet, it is in the public domain': *EPP v Levy* (2001) NSWSC 482 (6 June 2001).

[101] See eg *Interfirm Comparison (Australia) Pty Ltd v Law Society of NSW* (1975) 5 ALR 527.

[102] See McKeough and Stewart, above, pp. 91-95.

A domain name (an Internet address) is not a form of intellectual property as such. However because an Internet address is unique, some addresses have become valuable 'property' as the world of commerce has transformed the Internet. The use of trade marks within Internet domain names has become a major issue for intellectual property law in recent years.[103]

The registration of a domain name may be contested if someone else claims an interest in the name. Disputes of this kind may arise because of 'cybersquatting' (the registration of a name known to be of value to another), and also because more than one person has a legitimate claim to a name. Trade mark law has accommodated the use of the same or similar marks in unrelated fields and different jurisdictions. Domain name registration allows only one user of a specific address. The World Intellectual Property Organization (WIPO) Arbitration and Mediation Center has established a domain name dispute resolution service to deal with disputes of this kind.[104] The registration of names in the second level domain .gov.au is strictly regulated[105] and so is unlikely to be as problematic as other domains such as .com and .org. ***However, government agencies that interact with business in the digital environment should be aware of these issues surrounding the use of domain names.***

Discrimination in Access to Internet Facilities

Both federal and South Australian legislation prohibit various forms of discrimination in relation to the provision of goods and services. At the Commonwealth level, there are specific statutes dealing with discrimination on the grounds of disability, race and gender.[106] In South Australia, the *Equal Opportunity Act 1984* operates in parallel with the Commonwealth legislation. It prohibits discrimination on the grounds of sex, marital status, pregnancy or potential pregnancy, sexuality (including transsexuality), physical and intellectual disability, race and age.

Of these provisions, it is those dealing with disability discrimination that are potentially most relevant to the operation of websites and the provision of online facilities for e-commerce. It might be argued, for instance, that those who are sight-impaired, or who cannot distinguish certain colours, are discriminated against to the extent that they cannot effectively access, navigate through or gain information from a particular website.

Not every act that might otherwise be regarded as discriminatory in effect is necessarily unlawful. For example, in the context of disability discrimination it is a defence to plead that discrimination can only be avoided by the taking of measures that would impose an 'unjustifiable hardship' on the provider of the relevant goods or services. Nevertheless, there may be certain standards or procedures which those providing online services should

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[103] See eg A Upcroft, 'Trade Marks as Domain Names: An Australian Perspective' (1999) 3 Macarthur Law Review 43.

[104] See www.arbiter.wipo.int/domains/index.html.

[105] See www.govonline.gov.au/projects/wholeofgovonline/AustralianGovernmentDomainGuidelines.htm.

[106] *Disability Discrimination Act 1992*; *Racial Discrimination Act 1975; Sex Discrimination Act 1984*. See also *Human Rights and Equal Opportunity Act 1986*, which deals with a much broader range of discriminatory conduct but does not grant any enforceable rights.

routinely adopt for the benefit of users with particular disabilities — such as avoiding the use of unlabelled graphics (that is, images which lack text 'tags') that cannot readily be recognised and translated into artificial speech by the software typically used by the sight-impaired. This was, among other things, the basis for a successful complaint of disability discrimination brought last year by a sight-impaired person in relation to the official Sydney Olympic Games website.[107]

Various guidelines have been developed to assist website operators in addressing these issues, including by the World Wide Web Consortium (W3C) and the Human Rights and Equal Opportunity Commission (HREOC).[108] The Internet Industry Association (IIA) and the Australian Interactive Multimedia Industry Association (AIMIA), in conjunction with HREOC, are also in the process of developing an Accessibility Web Action Plan to meet the needs of web users with disabilities.[109]

Computer Crime

Computer crime covers a variety of offences. Computers may be used as tools in the commission of offences such as fraud against natural persons, and offences of that kind may also be committed against a computer directly. Other criminal activity may relate to unauthorised access to computer systems and corruption of data: what is commonly referred to as 'hacking'.

In January 2001 the Model Criminal Code Officers Committee (MCCOC) of the Standing Committee of Attorneys-General published a report on computer offences.[110] Under the proposed model code computer offences would cover unauthorised access to, and modification or impairment of, computer systems. The Committee believed that 'the intangible nature of computer technology is such that special offences are required'.[111] At the time of writing, a Bill is before the Commonwealth Parliament.[112] As the law currently stands the *Commonwealth Crimes Act 1914* includes offences relating to unauthorised access to, and damaging data in, Commonwealth computers. In South Australia, the

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107 Maguire v Sydney Organising Committee for the Olympic Games (Human Rights and Equal Opportunity Commission, No H99/115, 24 August 2000).

108 W3C Web Content Accessibility Guidelines 1.0 (www.w3.org/TR/WAI-WEBCONTENT/); Working Paper for E-Commerce Reference: Web Accessibility, Version 1.0, 1999: (www.hreoc.gov.au/disability_rights/inquiries/ecom/Webworking_paper.htm). See also Australian National Audit Office Better Practice Guide, 'Internet Delivery Decisions', 2001, Part 9 'How to Make Government Internet Sites More Accessible' (www.anao.gov.au); and note also the 'Bobby' software referred to below in conjunction with the review of the SA Central website.

109 A draft of the plan is available at www.iia.net.au/awap.html.

110 Model Criminal Code Officers Committee of the Standing Committee of Attorneys-General, Report, Chapter 4 Damage and Computer Offences, January 2001 (www.ag.gov.au/publications/Model_Criminal_Code/index.htm).

111 ibid, p. i.

112 Cybercrime Bill 2001 (Commonwealth).

unauthorised operation of a restricted access computer system (that is, one protected by a code of electronic impulses such as a password) is unlawful.[113]

The MCCOC did not propose special computer fraud and forgery offences. Instead, it recommended modifications to the traditional offences of obtaining property or financial advantage by deception and forgery so that they extend to deceptions practised on computers. These recommendations, which were set out in the Committee's 1995 Report,[114] have been implemented at a Commonwealth level in the *Criminal Code Act 1995* (Commonwealth). In South Australia a Bill to reform the criminal offences of dishonesty is currently before Parliament.[115] The Bill introduces a new offence relating to the dishonest manipulation of machines (which includes a computer) for benefit or to cause detriment.

The *Commonwealth Crimes Act 1914* also includes offences relating to telecommunications which are relevant to the Internet. These offences include the wrongful delivery of communications to someone other than the intended recipient, interference with carriage services, sale or possession of interception devices,[116] and the improper use of carriage services to menace or harass.

Government Policy and Standards

The Information Economy Policy Office was established to provide high level focus for the Information Economy for the South Australian Government and community generally.

In August 2000, the Premier of South Australia and the Minister for Information Economy launched the Information Economy 2002 vision statement (IE 2002 — Delivering the Future) which outlined a number of specific initiatives aimed to promote South Australia's beneficial participation in the information economy, including the adoption of Internet type technologies throughout the South Australian economy.

Parallel with this vision, DAIS has released its ICS Directions Strategic Plan which, amongst other things, will facilitate elements of the IE 2002 vision within the government sector. The ICS Directions Plan provides a broad planning framework to be adopted by government agencies for the next three years and recognises IE 2002 principles.

DAIS through its whole-of-government policy and standards setting role has in its current policy framework some specific areas covering Internet. These include the design of web pages, the registration of domain names and the use of Internet by staff.

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113 *Summary Offences Act 1953* (South Australia) section 44.

114 Model Criminal Code Officers Committee of the Standing Committee of Attorneys-General, Report, Chapter 3 Theft, Fraud, Bribery and Related Offences, December 1995 (www.ag.gov.au/publications/Model_Criminal_Code/index.htm).

115 Criminal Law Consolidation (Offences of Dishonesty) Amendment Bill 2001 (South Australia).

116 See also the *Telecommunications (Interception) Act 1979* (Commonwealth).

There are specific security and control policies at a whole-of-government level (DAIS), although those policies do not comprehensively cover e-commerce. DAIS is currently developing a whole-of-government information security framework based on the Australian/New Zealand Standard 4444 on Information Security Management. The framework will also include guidance for Public Key Infrastructure (PKI), which will provide a mechanism for the authentication and identification of government e-commerce users. Other aspects of e-commerce security and control will be addressed within the framework and in a planned series of supporting Best Practice Guidance statements.

Until finalisation, communication and implementation of the abovementioned policies/standards framework, it is the responsibility of individual agencies to secure and control their e-commerce operations in an appropriate manner. In this environment, Audit is of the opinion that DAIS needs to have a greater role in guiding and monitoring agency initiatives with respect to the introduction and operation of e-commerce facilities. In particular, specific guidance in the implementation of industry recognised better practice security and control arrangements would enable a more consistent approach to be taken across the whole-of-government sector.

LEGAL RISKS: A PRELIMINARY ASSESSMENT

Prior Audit Reports

Since 1996 I have reported on information technology developments within government agencies and made recommendations in relation to information technology policy. In my Reports for the years ended 30 June 1997, 1998, and 1999 I looked at the development and management of intellectual property assets and identified a range of risks associated with such matters.[117]

In 2000 I looked again at information technology policy and management arrangements, this time from the broader perspective of government use of web based e-commerce systems for communication and financial transactions. Audit concluded in that report that there are significant operational and financial risks associated with government agencies' operations within this changing information technology environment.

This year Audit has developed this review area further by considering the broad regulatory and policy framework that governs the e-commerce activities of government agencies and by making a preliminary assessment of some of the associated risks. As already indicated this will be developed further in Phase 2 of the review.

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[117] Reference is made to these reports in a major federal government policy document on the same subject, which picks up many of the themes I had earlier addressed and provides helpful guidelines for the management and development of IT-related intellectual property: Department of Communications, Information Technology and the Arts, The Commonwealth IT IP Guidelines, 2000 (available from www.dcita.gov.au).

Risks Identified for Further Review

In my previous Reports and in this Phase 1 review, I have identified a number of risks of a wide ranging general nature and highlighted specific examples associated with agency initiatives. These risks will be further explored by Audit.

In particular, the SA Central website preliminary Audit observations will be related on and explored in conjunction with the responsible agency, DAIS. Similarly, developments and action initiated by DIT in respect of suggested Bizgate improvements will be subject to further review.

The following section of my Report provides some commentary on risk areas identified from the review which will also be the subject of further examination as part of Audit's ongoing assessment of the area of electronic government.

Contracting Risks

There are risks associated with contracting with persons known only to the agency through some form of electronic interface. For instance, a contract may not be enforceable if it turns out the person was not legally competent to enter the agreement, because of their age or mental state.[118] There is also an obvious potential for fraud, for example by providing another person's credit card details without their knowledge in an endeavour to acquire particular goods or services. ***Procedures to assist with the verification of identity of persons transacting with agencies over the Internet accordingly need to be implemented.***[119]

Other risks associated with contracting with persons over the Internet concern the need to provide clear statements of the terms of agreements. Users of agency websites should have reasonable notice of any terms or conditions that the agency intends to form part of a contract governing these transactions. It is also imperative that those terms clearly deal with some of the issues highlighted in the earlier discussion of contract law as it affects electronic transactions, such as when and where contracts are concluded and which laws are to apply. Furthermore, it might reasonably be expected that government agencies would take the lead in ensuring compliance with consumer protection laws, to the extent these are relevant to the provision of goods or services online.[120]

Agreements between agencies, and between government and commercial service providers, that govern the provision of e-commerce services must also be properly documented. The

118 As to the legality of contracts entered into by those under 18, see *Minors' Contracts (Miscellaneous Provisions) Act 1979* (South Australia).

119 The Australian National Audit Office Better Practice Guide, Internet Delivery Decisions, 2001, Part 6 'Internet Systems Security and Authentication for Government Programs' (www.anao.gov.au) provides guidelines on how to address authentication issues when delivering government programs and services via the Internet. See also National Office for the Information Economy Government Online Group, Gatekeeper: The Commonwealth Strategy for the Use of Public Key Infrastructure (www.govonline.gov.au/projects/publickey/gatekeeper.htm).

120 See generally on this point Building Consumer Sovereignty in Electronic Commerce: A Best Practice Model for Business, issued by the federal Treasury Department and available at www.ecommerce.treasury.gov.au/publications.

case study that follows of the Bizgate project reveals another example of this requirement not being satisfactorily met, with potentially significant consequences for the allocation and identification of intellectual property rights in particular.

Inappropriate or Unlawful Content

When communicating electronically and providing Internet based services, agencies must ensure that the information they provide does not infringe the many laws that potentially regulate Internet content. Such information must not, for instance:

- be misleading or deceptive;
- consist of offensive, prohibited or unclassified material;
- have the effect of vilifying or harassing any person or group;
- be defamatory;
- breach privacy or confidentiality obligations;
- infringe intellectual property rights; or
- be unnecessarily difficult to access by persons with disabilities.

In order to avoid incurring liability under one or more of these headings, it is essential for agencies to implement appropriate risk management procedures.

In relation to websites, for example, there should be clear protocols in place for determining who may authorise the uploading of material, for ensuring that the content is suitable and appropriately presented, for including necessary legal notices (including disclaimers and notices relating to privacy, copyright and trade mark rights), and subsequently for monitoring the accuracy and currency of that information. Agencies can find guidance in this respect from the Protocols for Government Agency Public Access Web Pages, issued by DAIS.[121]

The demands that such a process of risk management imposes should not be underestimated, especially in relation to an issue as complex and technical as intellectual property rights. For example, those responsible for the content of government websites must ensure that for all material uploaded onto the site, either the copyright in that material is owned by the government, or a licence has been obtained from the owner for that specific use. A statement should also be included on the site explaining to users the extent to which they may use that material, and any conditions that they must comply with. It is important to keep in mind that a person may infringe by authorising someone else to infringe. If clear copyright statements and licences are not included, there is a risk of infringement by authorisation of intellectual property not owned by government.[122]

Similarly, the material on the website must not suggest an affiliation or association with another person or organisation that does not in fact exist. The use of logos or trade marks

[121] Available at www.government.ics.sa.gov.au/policy/REF10B-1.PDF.

[122] The question of licensing and of appropriate copyright statements is considered further below in relation to Audit's review of the SA Central website.

in web pages should be carefully monitored from this perspective. Hypertext links and framing of web pages should also be reviewed to ensure that users are not misled about the origins of the material before them. Carefully worded disclaimers should also be considered, although a disclaimer should not be relied upon as an answer to all risks associated with poor information management practices.

More generally, agencies need to ensure that the employment contracts or workplace agreements which govern the work activities of employees cover issues of e-mail and Internet use. Both media are means by which it is easy to access and distribute material which may give rise to liability for inappropriate content. Any workplace contract or policy governing the use of such media should include in it penalties for any misuse of the media, including dismissal and (possibly) indemnifying the South Australian Government against any penalties that may be imposed on the government as an employer who did not take adequate steps to prevent the offences occurring in the first place. They also need to alert employees to the fact their e-mails may be monitored for this purpose, and consider using rating and filtering software.

Once again, there are DAIS guidelines on this matter to which agencies may refer.[123] In my 1998-99 Report, however, I noted that while all agencies reviewed were found to have some form of policy covering integrity of employee use of e-mails and the Internet, few agencies had policies which conformed to best practice standards in this area.[124]

Audit intends in Phase 2 of this review to revisit this issue, with a view to determining whether the position has improved.

Information Management and Security

Along with the potential loss of audit trails discussed in the 2000 Audit Report, broader issues of information management must also be considered in an electronic environment: specifically the obligations of information retention and public access under freedom of information and archives legislation. Storage media should be selected that can ensure retention and access over the long term.

When government is involved in e-commerce a range of confidential or sensitive information may be collected. As with all such information held by government, there is an obligation to keep this data secure. Failure to do so may lead to legal action by the person to whom a duty of care is owed. Security of data must also be assured if agencies are to comply with the information privacy principles prescribed by Cabinet.[125] Security must be addressed in relation to both storage and communication of data to guard against unauthorised access.[126]

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123 www.government.ics.sa.gov.au/policy/POL2-10A.HTM.

124 Report of the Auditor-General for the year ended 30 June 1999, Part A. 4, pp. 76-78.

125 See section titled, 'Privacy and data protection'.

126 The Australian National Audit Office Better Practice Guide, Internet Delivery Decisions, 2001, Part 6 'Internet Systems Security and Authentication for Government Programs' (www.anao.gov.au) provides guidelines on security issues when delivering government programs and services via the Internet.

As mentioned in the previous section, Phase 2 of the review process will look at the direction being taken by government with respect to this matter.

PRELIMINARY CASE STUDIES — CASE STUDY 1: SA CENTRAL WEBSITE

Overview and Introduction

The South Australia Central website contains graphics and text and supplies information and links to websites to members of the public over the Internet.[127] It is intended to be the first and main point of contact for anyone seeking information as to the State or as to a variety of government and private services offered within it. As such it is an appropriate example to begin Audit's review of government websites.

Audit has examined the SA Central website, with a particular view to identifying any legal risks associated with its content and presentation, and the extent to which those responsible for the site have sought to address those risks.

Audit Observations

Ownership of Graphics

There are a number of graphics appearing throughout the website, including the SA Central logo. At the time of preparation of this Report, Audit had not finalised its examination of ownership and licensing of copyright in graphics. This matter will be further explored by Audit in conjunction with the responsible agency, DAIS.

Site Ownership

The important matter of site ownership, including appropriate contractual arrangements with the private sector businesses that helped to develop the site, similarly had not been fully examined by Audit at the time of preparation of this Report.

Privacy Statement

A link to a website page containing a Privacy Statement[128] is set in the footnote at the end of each website page. The Privacy Statement states that the policies in it are based on national and international standards and represent industry best practice. This statement should only be made after careful consideration. As previously noted,[129] South Australian Government agencies are presently required by a Cabinet instruction to comply only with a modified version of the Information Privacy Principles (IPPs) in the *Privacy Act 1988* (Commonwealth). Those IPPs, which have been described by a Senate Committee as not

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127 www.sacentral.sa.gov.au.

128 www.sacentral.sa.gov.au/privacy.html.

129 See above, 'Privacy and data protection'.

meeting ‘best practice standards’,[130] are far less stringent than the new National Privacy Principles to which some private sector organisations are now subject.

The Privacy Statement website page also contains links to the South Australian Cabinet version of the IPPs, located on the website of State Records, another government agency. There is no copy of the Cabinet version of the IPPs located on the SA Central website itself. This is not an issue provided the link to State Records is monitored for functionality on a regular basis.

The website page containing the Privacy Statement goes on to state the information collected by the government and the uses to which such information will be put from this website. There are also statements as to which other agencies or other branches of government may receive or access this information. The government must ensure that the access restrictions stated on this website page and in the linked IPPs are followed or the government will be vulnerable to potential actions for negligence or internal administrative action (involving the South Australian Privacy Committee) for breach of privacy.

The Privacy Statement is stated to be limited in its operation to the SA Central website. However, it is unclear from the nature of the displayed links when a user may have left or be leaving the website. This should be made more obvious.

The IPPs state that the information collected should be available to be accessed by the record-subject under the *Freedom of Information Act 1991*. While there is a link in the Privacy Statement to the Cabinet instruction version of the IPPs, there is no indication as part of the Privacy Statement itself that this access is available. While this is not strictly necessary, it would be in line with the Internet Industry Association (IIA) guidelines[131] to provide information to users of the website in relation to steps that may be taken by that user to complain or find out more information about what is held by the agency.

Disclaimer

A link to a disclaimer is located in the footer at the bottom of each website page. The disclaimer disclaims liability for the accuracy of information on the website or on linked websites, and states that use of information on the website is at the user’s risk. It should make the position clear that all linked sites are linked ‘as is’, that the government does not continually review or otherwise check such other sites, other than when such sites are first linked, and that any use of or reliance on such sites is at the user’s sole risk. It is also notable that there is no disclaimer in relation to the unavailability of the website for any reason.

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[130] Senate Legal and Constitutional Reference Committee, Inquiry into Privacy Issues, Including the Privacy Amendments Bill 1998, paragraph 4.3 (www.aph.gov.au/senate/committee/legcon_ctte/privacy/Chap4.htm).

[131] Available at www.iia.net.au/index2.html. A new draft of the IIA guidelines is available for public discussion at the moment, which will ensure compliance with the *Privacy Act 1988* for the private sector, assist with measures for the safety of children in their use of the Internet and provide operating methods which comply with the European Union Data Protection Directive to assist in commercial dealings with Europe.

The purpose of a disclaimer is to qualify the actions of a person, in this case the South Australian Government, and provide additional circumstances in which to consider such actions. It is typically used in the context of an action for negligence or misleading and deceptive conduct. The nature of the use of the Internet by the user is by way of licence to use from the owner of the website. The disclaimer is therefore not a contractual limitation of liability, but a mere qualifier to the actions of the owner of the website — the Government.

The disclaimer is accessible from each page, which is important. However there is no specific instruction or suggestion to the user that the disclaimer should be viewed and understood before the website is used/accessed. The legal effectiveness of a disclaimer is likely to be greater if it is drawn specifically to the attention of a user. It is common for websites to have disclaimers and other 'legal statements' at the foot of the page for those people who are interested to look at such things. However, it is a matter of fact whether sufficient notice of the disclaimer is given to a user who may not be as familiar with the practices of the Internet.

For that reason alone, it is difficult to assess whether the disclaimer is likely to be legally effective. The effectiveness of a disclaimer is in any event a matter of fact which is assessed by a court on a case by case basis.

Audit notes in this context that according to the DAIS Protocols for Government Agency Public Access Web Pages, all pages on public access sites operated by government agencies are required to be linked to the same standard disclaimer. While such a standard disclaimer may well be appropriate for many sites, including SA Central, it is also possible that there are sites where the legal risks to government are of a specific nature, and should be expressly addressed in any disclaimer. This is a matter which Audit will investigate further in Phase 2 when reviewing other agency websites.

Copyright Statement

A link to the website Copyright Statement is located in the footer of every page, dealing with use of the copyright material on the website. It is important that such a statement be present on the website to inform users what they can and cannot do with that material, and that it be written in reasonably plain language so that it can be readily understood.

The Copyright Statement notes that copyright exists in various works and other subject matter 'on and accessible' from SA Central. The government then grants a licence to its own copyright material but makes it clear that the licence does not extend to material not owned by the government. The material in which copyright is owned by the Crown is not identified as such, however, and it is therefore not clear over which material the licence is being granted.

The licence granted by the government is to download and display material. There is stated to be no licence to reproduce material (other than in the course of downloading it, presumably), and there is no licence specified to modify, publish or communicate the material. It is further stated that any use must be for private or non-commercial purposes.

It is unclear whether the licence extends to printing material from the website, though on a strict reading it would not (since printing involves a reproduction). It is also unclear what 'display' means. If printing is to be permitted under the licence, or for that matter prohibited, then this should be made clear.

Trade Mark Statement

There is a Trade Mark Statement contained in the footer of each web page identifying 'South Australia Central' as a registered trade mark. This statement is correct and should be further emphasised by placing either a ® mark or a ™ mark near the trade mark itself. Further, it should be stated that the trade mark must not be used other than in accordance with a licence from the government.

Website Link Selection Criteria

The Website Link Selection Criteria are the stated criteria which will be used to determine whether a submitted website link will be placed on the SA Central website. The criteria are displayed on a separate web page to which a link is provided from the page containing the web-based form to be submitted electronically to the South Australia Central team.

The criteria specify that a link will not be accepted unless the linked website meets certain criteria as to content and functionality.

There should be a disclaimer associated with the criteria noting that:

- there is no guarantee as to the length of time before a link appears on the SA Central website;
- there is no guarantee that the submission process will work and it is the responsibility of the person making the submission to check that the link appears and to contact SA Central if the link does not appear.

Linked Websites

It should be made clear to the user of the website when the user is leaving the website and consequently when the disclaimer and other legal provisions of the website will cease to operate. It is not currently clear where the SA Central website ends, in particular when the link is to a website also operated by the government or one of its agencies.

Access by Users with Disabilities

The SA Central website has attempted to ensure that it does not discriminate against persons with a physical disability, by obtaining 'Bobby approval status'. This status is self-conferred as a result of using a software application known as 'Bobby', which assesses websites for accessibility by people with disabilities. It is made available by the Centre for Applied Special Technology, a not-for-profit organisation which aims to 'expand opportunities for people with disabilities through innovative uses of computer technology'.[132] The site also has a text based (non-graphics) version which can be used to aid the sight impaired to access the information contained therein.

Concluding Comments

The foregoing represents some preliminary initial observations with respect to the SA Central website. These findings will be finalised and communicated to DAIS. Outcomes from the Phase 1 review will be applied in the context of the ongoing review of government agency websites to be addressed in Phase 2.

In broad terms, the SA Central website is well presented and has the legal features (disclaimers, privacy statement, copyright statement and statement of trade mark ownership) that would be expected of a good website. The review identified some aspects which may be further improved, but any good website is constantly evolving to take into account new suggestions, both in response to changing legal positions and to improve the website generally.

Audit will be further exploring certain aspects of the SA Central website and other agency website locations in Phase 2 of the review.

PRELIMINARY CASE STUDIES — CASE STUDY 2: BIZGATE

Overview and Introduction

What is Bizgate?

Bizgate is one of the key e-commerce initiatives of the South Australian Government. It is managed through the Business Channel within the Business Centre (Department of Industry and Trade (DIT)).[133] The Business Channel has been developed as a single entry point to enable business and the wider community to gain access to government information and to transact with government agencies over the Internet.

Bizgate initially came online in 1997, providing a number of business-related forms and some transactions that could be undertaken by fax or e-mail. It has developed considerably since then. Bizgate is currently providing a diverse range of e-commerce services to over 30 government and local government organisations including the provision of online forms and payment services.[134] At the time of writing, Bizgate was offering 33 online transactions including payment of rates, dog licences, business name renewals, parking fines, vehicle registration renewals, and payroll tax returns.

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132 www.cast.org/Bobby/AboutBobby313.cfm.

133 www.businesschannel.sa.gov.au.

134 www.bizgate.sa.gov.au.

Funding for Bizgate has been provided by DIT with some seed funding from the Department of Administrative and Information Services (DAIS). The project was also provided with Commonwealth government funding to assist with the development of the system and to integrate Bizgate with the Commonwealth Business Entry Point (BEP) and Business Licence Information Service (BLIS).

DIT has emphasised that Internet delivery of Government services is an emerging field and that through Bizgate South Australia has become a recognised national leader in the area. It has explained that these developments have been achieved in an environment where little experience and knowledge has previously existed. The Department attributes the success of the project largely to a policy of cautious implementation of new technologies and concepts and an informal project management style.

Audit's Review

Audit's review to date has highlighted a number of matters that need to be addressed given the extent to which Bizgate has evolved and developed.

The audit observations are outlined below along with responses that Audit has received from DIT from the preliminary review into the Bizgate arrangements.

Audit Observations

Policy, Management Reporting and Control Arrangements

The original project was developed in incremental fashion. It has evolved and developed, as Bizgate, into a significant e-commerce activity. However, important matters relating to policy, management reporting, and control arrangements have not changed markedly from the informal arrangements that applied in the early development stages. These arrangements need to be formally established and effectively implemented. This is acknowledged by DIT, which has indicated that it intends to seek advice and implement more appropriate arrangements.

Considering the government-wide nature of Bizgate operations, Audit believes that it is appropriate for DAIS and DIT to maintain a formal ongoing liaison concerning matters such as policy direction and security.

Contract and Service Level Agreements

The Bizgate services are provided to over 30 government and local government organisations principally operated through DIT computers housed with a contracted Internet service provider. Audit considers that some type of formal contract, service level agreement or formal documentation needs to be in place with respect to all parties involved, covering the full range of services to client organisations.

Audit enquiries have revealed only four finalised service level agreements. Only two of these were current and provided little beyond response and problem resolution times and a matrix of areas of responsibility for key functions. Audit noted the number of agencies without agreements, and the limited detail on important matters such as service levels, continuity of operations, intellectual property rights, and required security controls in those agreements that have been documented.

DIT has acknowledged some deficiencies in the documentation and intends to develop formal relationships with the agencies for which transactions are hosted and a generic service level agreement that can be used for all future transactions. In its response to Audit, DIT has emphasised the innovative technology and the development of knowledge in the management of online transactions within the Bizgate team that is not generally known within government. DIT advised that full documentation would be completed within four to five weeks.

Audit's view is that while projects of this kind evolve, the documentation of the project needs to evolve with it. Before a project goes beyond the initial stage and is implemented to conduct business and take online payments, as Bizgate has, formal documentation needs to be in place with all parties involved.

Continuity of Operations

While Bizgate operations are supported by backup hardware and software, there are no formalised continuity of operations arrangements with respect to the client organisations being serviced. Further, in the context of the limited formal documentation that does exist, there is some ambiguity as to the responsibility for disruptions to service which may occur and the implications for the client agencies. Audit considers a more formalised documentation arrangement of continuity of operations is required between all parties involved. Audit also notes that continuity of services is significantly dependent upon the availability and knowledge of the Project Manager.

These risks were also acknowledged by DIT. In August 2001 DIT reported to Audit that documents were being prepared that would mitigate that risk, predicting that full documentation would be completed within four to five weeks.

Systems Changes

Audit notes that there has been some informality with respect to the testing, implementation and documentation of significant system changes by a contracted service provider. Little formal documented evidence exists that changes by the contracted service provider have been tested in a formalised manner, with sign-off before acceptance supported by documented test cases.

DIT has advised that certain efficiencies were gained from minimising the documentation of system changes in the early stages of the project, but that there is now a need to formalise the process. A formal electronic project management system is intended for future system changes.

Formalised methods for documenting and evidencing the testing of system changes, which can operate in a practical and effective manner, should be implemented.

Intellectual Property

From the outset of the project there have been various attempts to address the issue of ownership of intellectual property rights in Bizgate, although with uncertain results. In an early (June 1998) consultancy and licence agreement between the Minister for Industry and Trade and the contracted service provider, all intellectual property rights in material produced by the service provider in the course of completing Stage 1 of the Bizgate project were to remain the property of the service provider.

Subsequent consultancy agreements, on the other hand, and also agreements between the Commonwealth and the State, purported to vest intellectual property in newly developed material in the State. However, correspondence between the parties raises some questions about what exactly was intended in this regard, particularly in relation to the source code.

It is apparent therefore that intellectual property rights in the project have been inconsistently assigned over the past few years. This matter is being addressed by the Department. DIT advised that the intellectual property rights should have resided with the contractual service provider. Audit has been advised that a draft agreement between DIT and the contracted service provider regarding the assignment of the intellectual property in the whole Bizgate project has been completed, and that both parties were expected to sign in the near future.

This case study has identified another example of a government agency that is dealing with ownership of intellectual property rights retrospectively by seeking an agreement from an outside party well after the intellectual property has come into existence. I refer in this context to the case studies discussed in the Audit Report for the year ending 30 June 1999.[135]

Concluding Comments

The review process highlighted some important matters which need to be addressed by DIT. Broadly, Audit considered that the Department's policy, management reporting and control arrangements, and formal documentation of the e-commerce arrangements with agencies and the private sector needed to be formally established with respect to the Bizgate facility. DIT has advised Audit of actions taken to address the observations.

In addition, ownership of intellectual property has again emerged as an issue for a government agency. This matter is also being addressed by DIT.

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[135] Report of the Auditor-General for the year ended 30 June 1999, Supplementary Report: Intellectual Property Management, pp. 31-40.