

SOUTH AUSTRALIA

Report

of the

Auditor-General

Pursuant to Section 22(2) of the *Electricity Corporations (Restructuring and Disposal) Act 1999*

Tabled in the House of Assembly and ordered to be published, 27 March 2001

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**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**

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2001



Auditor-General's Department

20 March 2001

The Hon J C Irwin, MLC
President
Legislative Council
Parliament House
ADELAIDE SA 5000

The Hon J K G Oswald, MP
Speaker
House of Assembly
Parliament House
ADELAIDE SA 5000

Gentlemen,

Pursuant to the provisions of section 22(2) of the *Electricity Corporations (Restructuring and Disposal) Act 1999*, I herewith provide to each of you a copy of my Report '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'.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K I MacPherson'.

K I MacPherson
AUDITOR-GENERAL

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GLOSSARY OF TERMS

The following terms are used in this Report:

Disposal Act	<i>Electricity Corporations (Restructuring and Disposal) Act 1999</i>
Disposal process	The process adopted and managed by the ERSU for the disposal of the government-owned electricity businesses
ElectraNet SA	Transmission Lessor Corporation (previously ETSA Transmission Corporation) trading as ElectraNet SA
EOI	Expressions of Interest sought from potential bidders for the relevant government-owned electricity business
ERSU	Electricity Reform and Sales Unit of the Department of Treasury and Finance
ETSA Power	ETSA Power Pty Ltd
ETSA Utilities	ETSA Utilities Pty Ltd
Flinders Power	Flinders Power Pty Ltd
Lead Advisers	Morgan Stanley Dean Witter and Pacific Road Corporate Finance - the business and financial advisers to the ERSU
MW	Megawatt
Optima Energy	Optima Energy Pty Ltd
Prescribed electricity assets	Comprises generation, distribution and transmission assets (including associated land) as defined in section 13 of the Disposal Act
Project Documentation	The sets of agreements, including leases, prepared by the ERSU for each bidder which set out the contractual terms and conditions for the disposal of the relevant electricity business
SAFA	South Australian Government Financing Authority
Synergen	Synergen Pty Ltd
Terra Gas trader	Terra Gas trader Pty Ltd

OVERALL CONCLUSIONS

A summary of the conclusions in this Report are as follows.

APPLICATION OF PROCEEDS TO RETIRE STATE DEBT

Electricity asset disposals have achieved an announced disposals value totalling \$5315 million. After adjustment to take account of retained debt and unfunded superannuation liabilities from the electricity entities and non-cash transfers to the private sector of unfunded superannuation liabilities, \$3965 million was available to meet State costs and other liabilities. However, as the retained liabilities are already included in the State's net debt figures, the gross proceeds less specific allowable applications were available to reduce net State debt.

Gross cash proceeds (that is not adjusted for retained liabilities) were \$5036.8 million of which \$4692.8 million was from long term leases and related transactions.

To 28 February 2001 the application of the gross cash proceeds included \$284.2 million for stamp duty, operating and disposal costs and the country price equalisation scheme. The Government has determined to use the stamp duty receipts for retirement of debt and to 28 February 2001 had appropriated \$142.9 million for this purpose.

The total available for debt retirement after adding back amounts equating to stamp duties and other known adjustments but before interest income, was \$4898.5 million representing 97.25 percent of the gross cash proceeds.

Proceeds including interest set aside in a special deposit account to 28 February 2001 specifically for debt retirement amounted to \$4958.1 million. Physical debt retirement to 28 February 2001 was \$4935.6 million. The balance of the account at 28 February 2001 was \$22.4 million with a further \$2 million expected to be credited to the account pending finalisation of various issues. The balance of any funds retained for operating expenses but not used will also be credited to the account when finalised.

INTEREST SAVINGS FROM RETIREMENT OF STATE DEBT

The estimates of savings herein reflect projected interest rates for forward periods. Variations to the projected rates will result in changes to the estimated savings.

Estimated interest savings for the non-financial public sector (excluding the effect of retained electricity entity debt) to 30 June 2001 arising from electricity asset disposals are expected to amount to \$261.4 million. It is estimated that savings in 2001-02 (ie a full year) will be \$264 million.

Estimated interest savings for the Budget (non-commercial) sector (including the effect of retained electricity entity debt) in 2001-02 (ie a full year) are about \$210 million.

EFFECT OF THE DISPOSALS ON THE PUBLIC FINANCES

Reduction of Risk Exposure

The Government has, by reducing debt, reduced debt management related risks and in particular outright interest rate risk. Following the announcement of the first electricity asset disposals in December 1999, the State achieved an improved credit rating to AA+. The Government has also reduced its risk exposure to operating businesses in the National Electricity Market by the disposal of the electricity businesses. This is offset by eliminating the opportunity to earn revenues and profits in that market and reducing the State's limited own source revenue base.

The estimated net benefit or premium on disposal of electricity assets to 30 June 2000 was \$115 million of which \$100 million had been built into the forward estimates in the 1998-99 Budget. This estimate excluded the effects of any disposals completed in 2000-01.

The data currently available indicate that the premium is achievable albeit based on the total proceeds from the disposal of all electricity businesses and lower interest rates than were initially estimated.

The Accounting Gain

The accounting gain from the disposal was \$1301 million reflecting the receipt of proceeds of \$4457 million for assets with a net book value of \$3156 million. In addition, proceeds of \$432.3 million were received with respect to future operating lease rentals relating to land with a book value of \$44.7 million.

Net Reduction in the Treasurer's Indebtedness

For the non-commercial sector, the net reduction in indebtedness of the Treasurer, which is the base for net interest payments in the Budget, over the period for 1999-2000 and 2000-01 to 28 February 2001, was \$3594 million.

The Matter of Whether a Fair Price was Received

It is not possible for Audit to form an opinion in relation to the fairness of the prices received for the Government-owned electricity businesses. However, information provided to Cabinet on the valuation of assets by the Government's Lead Advisers before each disposal, indicated that, overall, the total cash proceeds received, excluding stamp duty, exceeded the upper limit of the total estimated valuations of the assets.

PROBITY OF THE DISPOSAL PROCESS

Based upon the results of my review, I am of the opinion that although there are a number of matters I have identified that had the potential to undermine the probity of the disposal processes (including the process leading up to the making of each relevant long term lease), nothing has come to my attention to cause me to believe, and I do not believe, that these matters have in substantive terms affected the probity of the overall disposal process.

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

PART 1 INTRODUCTION

1.1 INTRODUCTION

In February 1998 the Government announced its plan for the reform and disposal of the government-owned electricity businesses in South Australia.

Parliament passed the *Electricity Corporations (Restructuring and Disposal) Act 1999* on 11 June 1999 (the Disposal Act), authorising the Government to proceed to:

- determine the most appropriate means of disposing of the assets and liabilities of an electricity corporation;
- examine the assets and liabilities of an electricity corporation;
- take action that the Minister authorises in preparation for disposal of assets and liabilities of an electricity corporation.

As the outcome of the disposal process is of fundamental importance to the continued financial viability and economic stability of the State of South Australia, it is important that the people of South Australia are assured that the processes developed and followed were sound.

Accordingly, the Disposal Act contains a provision for the Auditor-General to report to the Parliament on aspects of the disposal process.

1.2 AUDIT MANDATE

Under the Disposal Act:

... the Auditor-General must within the period of six months after the prescribed date, examine each relevant long term lease ... and prepare a report on:

- *... the proportion of proceeds of the leases used to retire State debt [subsection 22(2)(a)];*

- ... the amount of interest on State debt saved as a result of the application of those proceeds [subsection 22(2)(b)];
- ... the probity of the processes leading up to the making of each relevant long term lease ... [subsection 22(3)(a)].

In terms of the Disposal Act, the prescribed date, which is the earlier of the making of the last sale/lease agreement for all prescribed electricity assets or the second anniversary of the date of the first relevant long term lease, is 20 September 2000.

The Disposal Act is a major jurisdictional change in the audit responsibilities of the Auditor-General. In substantive terms, section 22 of the Disposal Act requires the Auditor-General to comment on the probity regarding the arrangements for the lease of the electricity assets.

In addition to the mandate provided under the Disposal Act, section 36(3) of the *Public Finance and Audit Act 1987* provides that:

The Auditor-General may, if the Auditor-General thinks fit to do so, prepare a supplementary report (and annex documents to it) relating to a matter required to be dealt with in an annual report and deliver that report to the President of the Legislative Council and the Speaker of the House of Assembly.

In terms of this section of the *Public Finance and Audit Act 1987*, I have already delivered a number of reports to Parliament in relation to the disposal processes for the government-owned electricity businesses, including:

- Supplementary Report of the Auditor-General on 'Electricity Businesses Disposal Process in South Australia: Arrangements for the Probity Audit and Other Matters: Some Observations' dated 28 October 1999;
- 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;
- Report of the Auditor-General for the year ended 30 June 2000: Part A — Audit Overview, pp 81-102.

In those Reports I stated that my obligations in respect of section 22 of the Disposal Act would be addressed in a later Report, which this Report represents.

1.3 BRIEF DESCRIPTION OF THE DISPOSAL PROCESS

The disposal process is governed by the provisions of the Disposal Act, which provided the authority for the disposal of the government-owned electricity businesses by way of lease, and in some cases, sale. The Disposal Act specifically prohibited the Crown, any instrumentality of the Crown, or a statutory corporation from selling or transferring either 'prescribed electricity assets' or shares in a company that owns (or has a subsidiary that owns) 'prescribed electricity assets'. Prescribed electricity assets were defined under the Act as any of the following situated in South Australia:

- electricity generating plant with a generating capacity of 10 MW or more;
- power lines (including their supporting or protective structures or equipment and associated equipment for the transmission or distribution of electricity);
- sub-stations;
- land on or under which infrastructure of the kind referred to above is situated.

Subject to these prohibitions, the Treasurer was authorised to grant a lease, easement or other rights in respect of the assets of one or more of the government-owned electricity businesses. As a result, it was permissible for 'prescribed electricity assets' to be leased.

Section 17 of the Disposal Act, provides that the Minister is to endeavour to ensure that a 'prescribed long term lease' in respect of 'prescribed electricity assets' contains a number of terms.

The Act also made provision for the restructuring of the government-owned electricity assets prior to any disposal process commencing. As a result of this restructuring process, the following entities were established:

- *ETSA Utilities Pty Ltd* — whose primary function was to operate and manage the electricity distribution network in South Australia;
- *ETSA Power Pty Ltd* — whose primary function was to retail electricity;
- *ElectraNet SA* — whose primary function was to operate and manage the electricity transmission network in South Australia and to perform system control functions;
- *Flinders Power Pty Ltd* — which operated the brown coal fired power stations at Port Augusta. The company also operated a coal field at Leigh Creek and owned the railway line linking the coal field with the power stations;

- *Optima Energy Pty Ltd* — which operated the gas fired power stations at Torrens Island;
- *Synergen Pty Ltd* — which operated gas turbine generators at four locations;
- *Terra Gas trader Pty Ltd* — which managed gas contracts.

To manage the reform, restructure and disposal processes for the government-owned electricity businesses the 'Electricity Reform and Sales Unit' (ERSU) was established within the Department of Treasury and Finance. The ERSU was staffed by officers seconded principally from the Department of Treasury and Finance with much of the technical work being undertaken by consultants.

The Treasurer selected a Lead Adviser, together with a range of other consultants for specific subject areas, including:

- Legal (incorporating probity advice)
- Accounting
- Actuarial
- Communications
- Economic
- Engineering
- Environmental
- Project Management.

A number of protocols/rules/procedures were adopted by the ERSU to govern the bidding process. A number of these were designed to specifically address the probity of the disposal process.

These protocols/rules/procedures have been incorporated in documents, including:

- Roadshow protocols
- EOI protocols
- Probity Rules (and supplements thereto)
- Bidding Rules (and supplements thereto).

A summary of the issues arising from these documents was provided in a previous Report.¹

In addition, the Treasurer appointed a Probity Auditor to report directly to him on the probity of the disposal process. The Probity Auditor was independent of those involved in the conduct of that process. Details of the scope of the work undertaken by the Probity Auditor,

¹ 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.

which focused specifically on the fairness of the process to bidders, were discussed in a previous Report.²

The disposal process was conducted via a series of sequential 'trade sales'. These generally followed a process that included:

- ***Expressions of Interest (EOI).*** Those parties who expressed interest were evaluated as to whether they met the following criteria:
 - financial capability to complete the transaction;
 - operational or investment experience;
 - consistency with Federal competition law and South Australian cross ownership restrictions;
- ***Commitment to a Process Contract and Confidentiality Undertakings.*** Those parties qualified through the EOI process were required to sign up to the process contract set out in the Bidding Rules for the relevant disposal and sign confidentiality undertakings before they were permitted to further participate in the disposal process;
- ***Issue of Information Memoranda.*** The Information Memoranda concerning the assets being disposed of were issued to those parties who qualified through the EOI process and who signed up to the process contract and confidentiality undertakings.
- ***Indicative Bid.*** Indicative Bids, including indicative pricing for the businesses, were invited from those parties who qualified through the EOI process. An Indicative Bid stage was not included in the ElectraNet SA disposal process.
- ***Due Diligence.*** Those parties who were shortlisted as a result of evaluation of their Indicative Bids were given access to data rooms and to the management of the electricity businesses to conduct full due diligence in relation to the businesses.
- ***Final Bid.*** Those parties shortlisted after evaluation of their Indicative Bids were invited to lodge Final Bids.
- ***Negotiation Stage.*** Where the bids received were not acceptable due to an assessment of the risk issues associated with the bids and the quantum of the price offered, the State undertook negotiations with one or more parties before deciding as to who to contract with. The agreements known collectively as the benchmark Project Documentation were progressively negotiated with all bidders from the time of shortlisting of the Indicative Bid stage through to selection of the successful bidder.

² Supplementary Report of the Auditor-General on 'Electricity Businesses Disposal Process in South Australia: Arrangements for the Probity Audit and Other Matters: Some Audit Observations' dated 28 October 1999.

- ***Execution of Business Sale Agreement.*** An Offer Deed was executed with the successful final bidder. A completion period then followed before execution of the Business Sale Agreement occurred and the relevant leases took effect.

A summary of the information relating to the disposals is included in this Report under the heading '2.2 — Summary of Disposals'.

A copy of each relevant long term lease, together with a prescribed report relating to the lease,³ was required to be tabled in Parliament. Copies of the leases and associated prescribed reports were tabled in the House of Assembly on 1 March 2001 and, in the Legislative Council on 13 March 2001.

1.4 STRUCTURE OF THIS REPORT

This Report comprises an introductory Part followed by four other Parts.

Part 2 comprises a commentary on the use of the proceeds from the disposals.

Part 3 comprises a commentary on the estimated interest savings resulting from the use of the disposal proceeds to retire debt.

Part 4 comprises a general commentary on the effect of the disposal on the Public Finances.

Part 5 comprises a commentary on the probity of the disposal process.

³ Prescribed report is defined in section 13 of the Disposal Act and summarises the principle features of the lease, and states in present value terms the total amount paid or to be paid to the State under or in connection with the lease.

PART 2 COMMENTARY ON USE OF PROCEEDS

2.1 INTRODUCTION

This Part of the Report comments on the proceeds received and their use, particularly to retire State Debt.

The scope of this Part covers the following:

- Summary of Disposals
- Net Value of Proceeds from the Disposal of Electricity Businesses
- Application of Proceeds - legislative provisions
- Administrative arrangements
- Application of Disposal Proceeds

As at 28 February 2001 some final adjustments had yet to be completed in relation to the determination and application of proceeds. These remaining issues are referred to where relevant in the commentary.

Some tables in this Report may not add due to rounding.

2.2 SUMMARY OF DISPOSALS

Settlement of the first sale/lease, for ETSA Utilities and ETSA Power, occurred on 28 January 2000 and the final settlement for Terra Gas trader and ElectraNet SA took place on 31 October 2000.

The following disposals have taken place and the gross proceeds, including stamp duty, received were:

Summary of Disposals

Entity	Date Announced	Date Proceeds Received	Announced Disposal Value \$'million	Composition of Value	
				Cash \$'million	Liabilities Transferred (a) \$'million
ETSA Utilities/Power (b)	11 Dec 1999	28 Jan 2000	3 500.0	3 405.4	94.0
ETSA Power (c)	14 Jan 2000	28 Jan 2000	25.0	25.0	0
Optima Energy	4 May 2000	6 June 2000	314.9	295.0	19.9
Synergen	11 May 2000	6 June 2000	39.0	35.6	3.4
Flinders Power	3 August 2000	8 September 2000	462.9	314.4	148.5
ElectraNet SA	20 September 2000	31 October 2000	938.0	926.4	11.6
Terra Gas trader	23 October 2000	31 October 2000	35.5	35.0	0.5
Total			5 315.3	5 036.8	277.9

(a) Comprises unfunded superannuation liabilities transferred to private operators and for Flinders Power includes \$117.6 million of other projected liabilities taken over by lessee.

(b) Table totals do not add as announced disposal value includes \$0.5 million ETSA Power resale costs claimed by CKI/HKE.

(c) Onsold with disposal proceeds greater than \$150 million reverting to the State.

With respect to the requirement in the Disposal Act for the Auditor-General to report on the proceeds from relevant long term leases and related transactions, the total gross proceeds were comprised as set out in the following table. Other amounts relate to proceeds from the sale of ETSA Power and Terra Gas trader that were not within the definitions of relevant long-term leases in the Disposal Act and stamp duties.

Composition of Proceeds

Item	Relevant Long Term Leases and Related Transactions \$'million	Other Amounts \$'million	Total Amount \$'million
Asset leases	3 962.3	-	3 962.3
Land leases	519.0	-	519.0
Asset sales	211.5	200.3	411.8
Provision for stamp duty	-	143.7	143.7
Total	4 692.8	344.0	5 036.8

2.3 NET VALUE OF PROCEEDS FROM THE DISPOSAL OF ELECTRICITY BUSINESSES

Before disposal, the net value of the electricity assets to the State was represented by the difference between the value of assets and liabilities as reflected in the accounts of the entities. In the disposal process certain assets and liabilities were retained by the State and the balance exchanged for the disposal proceeds. In the Whole-of-Government Financial Statements, discussed later, the accounting result of the disposals will be reflected as the difference between the net book value of physical and other assets previously owned by the State and the cash proceeds received for those assets.

Readers will be more familiar with the announced proceeds than the accounting result. It is in relation to the proceeds that there is an expectation of debt reduction. The following table sets out, in relation to the completed disposals, the detail of any of the assets and liabilities retained by the State before disposal and the disposal proceeds. This table aims to assist readers with the determination of the net value to the State of all the assets and liabilities held in relation to the electricity entities after the disposals were completed. The table does not include contingent liabilities arising from the operations of the electricity businesses or from the disposal process.⁴

⁴ Discussion of retained liabilities is set out on pp 137 and 138 of my 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.

Estimation of Net Value Arising from Electricity Businesses Disposals

	\$'million	\$'million
Announced value of proceeds from disposals		5 315.3
Less: Retained electricity entity liabilities		
Debt (a)	1 005.0	
Unfunded superannuation	67.0	
		1 072.0
Net Value (b)		4 243.3
Less: Value of unfunded superannuation liabilities transferred to private operators		160.3
Value of other projected liabilities transferred to private operators		117.6
Value of ETSA Power resale costs claimed by CKI/HKE		0.5
Net Value available to cover State costs and other liabilities		3 964.9

- (a) This is the estimated market value of debt retained. The carrying or book value was \$926 million.
 (b) Includes unfunded superannuation and other liabilities transferred to private operators.

The table shows that the net value of the electricity asset disposals to 28 February 2001, that is, the change in financial assets after the disposals, is estimated to be \$3964.9 million. To this extent the State has covered the market value of any retained net liabilities prior to the disposal of the electricity entities. That is, this is the amount available to cover State costs and other liabilities. It should be noted that this amount is derived after allowing for the amounts of \$160.3 million being the value of unfunded superannuation liabilities and \$117.6 million for other projected liabilities transferred to private operators. Those amounts were not cash proceeds but have the effect of reducing the State's superannuation and other liabilities.

The amount of \$3964.9 million is not, however, the amount that will be referred to in relation to debt retirement. A higher amount based on cash proceeds (\$5036.8 million) net of allowable costs is used for that purpose. There are two reasons for this. Firstly, the debt retained (except for a notional amount as explained below) was included in net debt calculations in past years - the gross proceeds are applied to that debt. Secondly, the cash proceeds were not used to fund the retained unfunded superannuation liabilities of \$67 million.

2.3.1 Retained Debt

As can be seen from the previous table, prior to disposal, debt with an estimated market value of \$1005 million was transferred to the Treasurer. The book value of this debt was \$926 million. This debt was included in the calculation of net debt in past years (in the net debt of public non-financial corporations). An amount of \$79 million was notionally added to the debt for the purposes of this presentation and for determining Budget net interest savings.⁵ The additional amount reflects the fact that interest rates for the debt exceeded market values at the time of transfer. This debt will now be serviced by the non-commercial sector, having previously been serviced by the commercial sector. If retired early, then as

⁵ The Department of Treasury and Finance incorporated this adjustment, and Audit considers correctly so, in the figuring to estimate interest savings for the Budget (non-commercial) sector.

with any debt, to the extent that the interest rates on that debt exceed market rates, a premium is payable and accounting losses will be incurred.

2.3.2 Retained Unfunded Superannuation Liabilities

The table also shows that the State retained unfunded superannuation liabilities to the value of \$67 million. This liability represents superannuation obligations to former employees of the electricity entities who had ceased employment before the disposals occurred. These unfunded liabilities were previously included in the calculation of unfunded liabilities and consequently, the balance of unfunded liabilities is not increased. However, because this liability would have been previously met by the electricity entities, it was not included in the Government's program for funding past superannuation liabilities. The funding program has accordingly been increased.

2.3.3 Assessing the Net Financial Position

In summary, the relevance of the table is to indicate that proceeds are to a degree offset by retained liabilities in assessing the net position from the disposal of the electricity assets. The position is not that the State has exchanged its electricity businesses for \$5 billion but has retained some liabilities of those businesses for a net position (excluding contingent liabilities) of about \$4 billion after covering all electricity entity unfunded superannuation liabilities and debt. If the State had transferred the retained liabilities to the private operators, the price received would have been reduced by the bidders valuation of the liabilities. As mentioned, later in this Part a comparison of the reported whole-of-government financial position is discussed.

2.4 APPLICATION OF PROCEEDS - LEGISLATIVE PROVISIONS

The Treasurer must apply the proceeds from the disposal of electricity assets according to the provisions of the Disposal Act. Key provisions of the Disposal Act are as follows:

- (1) *The Treasurer may only apply proceeds of a sale/lease agreement under this Act as follows:*
 - (a) *in payment of an amount equal to any payment made by an electricity corporation, or a body by which assets or liabilities have been acquired under a transfer order, on the termination or surrender of a lease entered into before 17 November 1998;*
 - (b) *in payment of the costs of restructuring and disposal of assets of electricity corporations and preparatory action taken for that purpose;*
 - (c) *in payment to an account at the Treasury to be used for the purposes of a scheme to limit differences between electricity*

prices charged to classes of consumers in non-metropolitan areas and those charged to corresponding consumers in metropolitan areas.

- (d) *in payment to an account at the Treasury to be used for the purposes of retiring State debt.*
- (2) *Any income from investment of money paid into an account at the Treasury under subsection (1) must be applied for the purposes of retiring State debt.*
- (3) *An amount paid by way of security will not be regarded as proceeds of a sale/lease agreement for the purposes of this section.⁶*

Details of application of the proceeds follow in this Part of the Report.

2.5 ADMINISTRATIVE ARRANGEMENTS

To assist with the administration of the application of proceeds in accordance with the requirements of the Disposal Act, the Department of Treasury and Finance established special deposit accounts as follows:

Electricity Reform and Sales Operating Account — an existing account, the purposes of which were amended, to allow proceeds from disposals to be credited to the account and applied to any of the legislated applications including transferring proceeds to the Electricity Sale/Lease Proceeds Account.

Electricity Sale/Lease Proceeds Account — an account established to receive disposal proceeds and interest earned on those proceeds and to apply those monies toward the retirement of debt.

Both accounts may be credited with disposal proceeds but credits in the Electricity Sale/Lease Proceeds Account may only be used for debt retirement. Both accounts are interest bearing to comply with section 21(2) of the Disposal Act.

⁶ Section 21 *Electricity Corporations (Restructuring and Disposal) Act 1999*. The remaining provisions of that section are:

- (4) *An electricity corporation must, if the Treasurer so directs, make a specified payment to the Treasurer.*
- (5) *A State-owned company must, if the Treasurer so directs, make a specified payment to the Treasurer.*
- (6) *The Minister must establish, maintain and operate a scheme (funded initially by the account referred to in subsection (1) (c) and subsequently by money appropriated for the purpose) for the purposes of ensuring that the electricity price charged to any small customer who is supplied electricity through the transmission network in South Australia, but not generally through a metropolitan transmission network connection point, will not exceed 101.7 percent of the electricity price charged to a corresponding small customer, with the same levels and patterns of consumption, who is generally supplied through a metropolitan transmission network connection point.*

2.6 APPLICATION OF DISPOSAL PROCEEDS

Proceeds from disposals were first received on 28 January 2000, the date of the settlement of the first lease. Audit reviewed the application of all proceeds for compliance with the provisions of the Disposal Act.

In summary, the proceeds, their application and expected adjustments to 28 February 2001 were as follows:

Proceeds, their application and expected adjustments to 28 February 2001

	\$'million
Gross cash proceeds	5 036.8
Less: Application for purposes other than debt retirement	284.2
Net proceeds available for application to debt retirement	<u>4 752.6</u>
Add: Return of stamp duty and other adjustments	143.8
Total available for debt retirement before interest income and adjustments	<u>4 896.4</u>
Add: Expected adjustments	2.0
Total available for debt retirement before interest income	<u>4 898.5</u>

The total available for debt retirement before interest income represents 97.25 percent of the gross cash proceeds.

2.6.1 Application of Gross Proceeds to Purposes Other than Debt Retirement

The following table sets out details of applications of proceeds to purposes other than debt retirement.

Applications of Proceeds to Purposes Other than Debt Retirement

Entity	Stamp Duty \$'million	Retained for Operating Costs \$'million	Disposal Costs - Entity Specific \$'million	Excess Stamp Duty and Amounts Paid to be Recovered \$'million	Country Price Equalisation Scheme \$'million	Total \$'million
ETSA Utilities/ETSA Power	103.9	65.7	11.7	1.3	-	182.6
Optima Energy	5.7	-	0.6	-	-	6.3
Synergen	0.9	-	0.3	0.2	-	1.4
Flinders Power	10.7	-	4.3	0.3	-	15.3
ElectraNet SA	19.4	45.0	0.5	0.9	10.0	75.8
Terra Gas trader	2.3	-	0.2	0.3	-	2.8
Total	<u>142.9</u>	<u>110.7</u>	<u>17.6</u>	<u>3.0</u>	<u>10.0</u>	<u>284.2</u>

2.6.1.1 Stamp Duty

Gross proceeds for each of the disposal transactions to 28 February 2001 included amounts to provide for stamp duty. Stamp duty is a State tax rather than disposal proceeds and the

law requires the receipts to be credited to the Consolidated Account. Subsequently, the Government has made payments of \$142.9 million as at 28 February 2001, equal to the assessed stamp duty, from the Consolidated Account to the Electricity Sale/Lease Proceeds Account for the purpose of debt retirement. The amounts in the table were amounts set aside in the Electricity Reform and Sales Operating Account as part of a provision for stamp duty. Where amounts provided for stamp duty exceeded actual assessed stamp duty, the balance was transferred to the Electricity Sale/Lease Proceeds Account (Proceeds Account) and made available for debt retirement. The excess amounts are included in the table under 'Excess Stamp Duty and Amounts Paid to be Recovered'

2.6.1.2 Operating and Disposal Costs

Funds have been provided from the cash proceeds to cover the operating costs of the Electricity Reform and Sales Unit (ERSU) and other disposal costs. The following briefly summarises the operating and disposal costs.

Operating Costs

The ERSU was established to administer the reform and disposal of the State's electricity businesses. Its principal costs are payments of consultants' fees for those consultants involved in this process over the four years including 2000-01. The final accounts for the ERSU will be prepared as at 30 June 2001 at which time final details of the ERSU's financial transactions will be presented.

In relation to the disposal of ETSA Utilities/ETSA Power, the Treasurer authorised \$65.7 million be retained by the ERSU to finance its operating costs. The Treasurer authorised an additional \$45 million to be retained from the proceeds of ElectraNet SA for the remaining ERSU costs. As mentioned, the accounts for the ERSU are not yet finalised. When this occurs, any unused funds will be credited to the Proceeds Account for application to debt retirement.

Disposal Costs

The ERSU retained from disposal proceeds an amount of \$17.6 million to meet entity specific disposal costs. The principal disposal cost related to the purchase of leased vehicles, which for all entities amounted to \$16.4 million. This related to the cost of acquiring vehicles from a lessor to allow transfer of the vehicles to the new operators. Other disposal costs were for the reimbursement of bidder costs for the Flinders Power disposal, directors' completion fees and for executive retention fees that are recoverable from lessees.

Amounts Paid to be Recovered

Monies have been retained in the Electricity Reform and Sales Operating Account to meet certain contingency payments and any balance not so used will be used, together with executive retention fees recovered, for debt retirement.

Country Price Equalisation Scheme

The Government has retained \$10 million of the proceeds funds in the ERSU account for the purposes of subsection 21(1)(c) of the Disposal Act, that is, for the purposes of a scheme to limit differences between electricity prices charged to classes of consumers in non-metropolitan areas and those charged to corresponding consumers in metropolitan areas.

Section 21(6) requires that the Minister must establish, maintain and operate a scheme (funded initially by the account referred to in subsection 21(1)(c) and subsequently by money appropriated for the purpose) for the purposes of ensuring that the electricity price charged to any small customer who is supplied electricity through the transmission network in South Australia, but not generally through a metropolitan transmission network connection point, will not exceed 101.7 percent of the electricity price charged to a corresponding small customer, with the same levels and patterns of consumption, who is generally supplied through a metropolitan transmission network connection point.

As at 28 February 2001 the Department of Treasury and Finance has not established a special deposit account specifically for this purpose.

2.6.1.3 Other Provisions of the Disposal Act

No funds had been set aside as at 28 February 2001 for the purposes of section 21(a) of the Disposal Act, that is, for the termination or surrender of a lease entered into before 17 November 1998.

2.6.2 Net Proceeds Applied to Debt Retirement

The total amount deposited or expected to be deposited to the Electricity Sale/Lease Proceeds Account for debt retirement as at 28 February 2001 was \$4.96 billion. The composition of this amount is set out in the following table.

Description	\$'million
Net proceeds after applications for other purposes but before final adjustments	4 896.4
Interest earned	61.7
Total available for debt retirement before adjustments	4 958.1
Expected adjustments	2.0
Total available for debt retirement	4 960.1

As can be seen interest earned on proceeds invested to 28 February 2001 and deposited in the account, as required under section 21(2) of the Disposal Act, amounted to \$61.7 million. This represents the cash transfers to the account to that date.

The application of net proceeds to debt retirement and balance of proceeds to 28 February 2001 was:

	Number of Deals	Principal \$'million	Total \$'million
Total available for debt retirement			4 958.1
Debt retirement — Natural maturity	374	4 416.7	
Debt retirement — Early retirement	223	518.9	
Total debt retirement		<u> </u>	4 935.6
Balance			<u> </u> 22.4

As indicated, total physical debt retirement amounted to \$4935.6 million. Some early retirement of debt (\$518.9 million) took place as was determined by SAFA to be to the advantage of the State. The difference between the carrying (book) value and market value on early retirement shows as gains or losses on debt retirement. The early retirements incurred book losses of \$38.4 million. This amount was transferred to the Treasurer's debt as discussed later in this Report under the heading '4.5 — Treasurer's Indebtedness'. Generally, debt will be repurchased prior to maturity where yields are higher or equivalent to those derived by reference to SAFA's domestic funding cost. That is, higher than market interest rate debt may be retired to reduce the ongoing average interest cost of remaining debt.

2.6.2.1 Amounts not Finalised

At the time of this Report an amount of \$2 million was identified as being available for debt reduction. Audit will confirm the application of funds as and when this occurs. In addition, as mentioned previously, any unused balances from other funds retained to meet expenses of the ERSU will be used for debt retirement.

2.7 CONCLUSIONS ON USE OF PROCEEDS

Electricity asset disposals have achieved an announced disposals value totalling \$5315 million. After adjustment to take account of retained debt and unfunded superannuation liabilities from the electricity entities and non-cash transfers to the private sector of unfunded superannuation liabilities, \$3965 million was available to meet State costs and other liabilities. However, as the retained liabilities are already included in the State's net debt figures, the gross proceeds less specific allowable applications were therefore available to reduce net State debt.

Gross cash proceeds (that is not adjusted for retained liabilities) were \$5036.8 million of which \$4692.8 million was from relevant long term leases and related transactions.

To 28 February 2001 the application of the gross cash proceeds included \$284.2 million for stamp duty, operating and disposal costs and the country price equalisation scheme. The Government has determined to use the stamp duty receipts for retirement of debt and to 28 February 2001 had appropriated \$142.9 million for this purpose.

The total available for debt retirement after adding back amounts equating to stamp duties and other known adjustments, but before interest income, was \$4898.5 million representing 97.25 percent of the gross cash proceeds.

Proceeds including interest set aside in a special deposit account to 28 February 2001 specifically for debt retirement amounted to \$4958.1 million. Physical debt retirement to 28 February 2001 was \$4935.6 million. The balance of the account at 28 February 2001 was \$22.4 million with a further \$2 million expected to be credited to the account pending finalisation of various issues. The balance of any funds retained for operating expenses but not used will also be credited to the account when finalised.

PART 3 COMMENTARY ON ESTIMATED INTEREST SAVINGS

3.1 INTRODUCTION

There are two key perspectives in relation to calculations of interest savings that are of interest for the purposes of this Report namely:

- Estimated interest savings for 2000-01 being savings accumulated as and when leases/sales were settled during the disposal process and for a full financial year, 2001-02 - based on total proceeds available for debt retirement and projected interest rates relevant to the period.
- Estimated savings for the non-commercial and commercial sectors and the 2000-01 Budget Estimates;

These are discussed in turn in this Part.

It is also critical to note that the estimates of savings herein reflect projected interest rates for forward periods. Variation in the projected rates will result in changes to the estimated savings.

3.2 ESTIMATED INTEREST SAVINGS FOR 2000-01 AND 2001-02

The following interest saving calculations are based on the net proceeds before adjustment for retained electricity entity debt. It therefore reflects debt and related interest savings for the non-financial public sector. Part 4 of this Report considers Budget related data which is adjusted for electricity entity retained debt.

The interest saving for 2000-01 is estimated to be \$261.4 million. This amount is determined by the following calculation.

Total Interest Savings Estimate for 2000-01

Disposals Entity	Period	Net Cash Proceeds (a) \$'million	Interest Rate (b) Percent	Interest Saving (c) \$'million
ETSA Utilities/ETSA Power	July - December 2000	3 353.1	6.34	107.2
Optima Energy	July - December 2000	294.4	6.34	9.4
Synergen	July - December 2000	35.3	6.34	1.1
Flinders Power	September - December 2000	310.0	6.23	6.0
ElectraNet SA	October - December 2000	870.8	6.08	8.8
Terra Gas trader	October - December 2000	34.8	6.08	0.4
All entities	January - June 2001	4 898.5	5.29	128.5
Total Estimate for 2000-01				261.4

- (a) Received and expected proceeds net of costs and including provision for stamp duty.
 (b) Average interest rates for the period and forward projections as at 31 January 2001.
 (c) Interest saving for the part year.

The interest saving for 2001-02 is estimated to be \$264 million based on an estimated average interest rate of 5.39 percent. Of this, savings associated with the use of stamp duties receipts for debt reduction are estimated to be \$7.7 million.

Total Interest Savings Estimate for 2001-02

Disposals Entity	Period	Net Cash Proceeds \$'million	Interest Rate Percent	Interest Saving \$'million
All entities	July 2001 - June 2002	4 898.5	5.39	264.0

The interest rates used were determined as best suited the relevant timeframes from one of:

- the month end average market interest rates applying to debt of SAFA's average maturity and credit rating, ie SAFA's estimated average prevailing borrowing cost for its 2.8 year benchmark modified duration portfolio;
- a daily average - used for short time frames;
- a best estimate - used for forward periods.

While this approach does not provide absolute precision in the calculation of interest savings, it is not considered to lead to materially inaccurate information and is administratively efficient. For example, information as to particular debt maturing or being repurchased is not required. The approach is supported by the fact that any transaction with the financial markets will be based on prevailing market rates. As such, renewal of a maturing debt or early redemption of debt will be based on current market rates.⁷ By having the proceeds from asset disposals available to retire debt, the State is avoiding paying those prevailing rates.

The following table provides an indication of the effect of changes to interest rates on estimated interest savings.

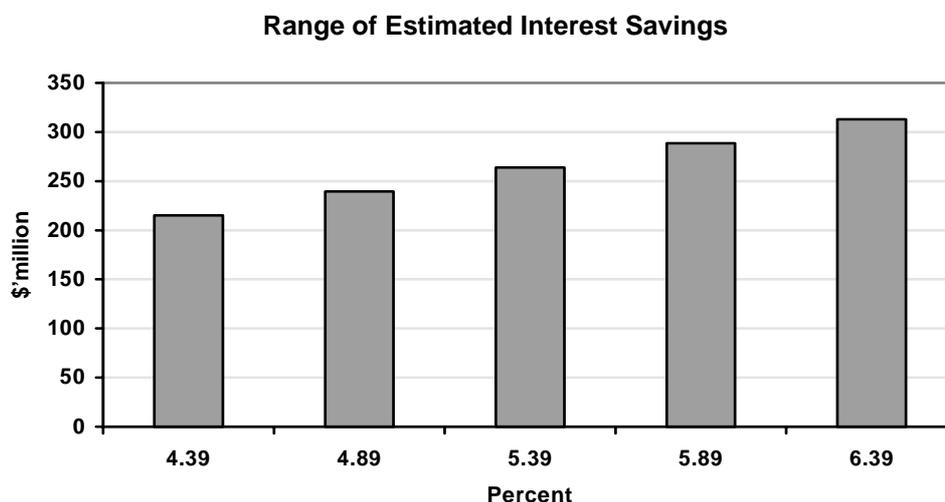
**Total Interest Savings Estimate for 2001-02
Under Different Projected Interest Rates**

Disposals	Period	Net Cash Proceeds \$'million	Interest Rate Percent	Interest Saving \$'million
All entities	July 2001 - June 2002	4 898.5	4.39	215.0
All entities	July 2001 - June 2002	4 898.5	4.89	239.5
All entities	July 2001 - June 2002	4 898.5	5.39	264.0
All entities	July 2001 - June 2002	4 898.5	5.89	288.5
All entities	July 2001 - June 2002	4 898.5	6.39	313.0

⁷ Examples are (1) If the State had debt with an interest rate of 10 percent maturing on 30 June 2000 and prevailing rates were 6 percent, the interest avoided is 6 percent. (2) If \$1 million of debt with an interest rate of 10 percent and two years to maturity was repurchased at 30 June 2000 ie before maturity, with prevailing rates of 6 percent, it would cost \$1.07 million to repurchase that debt, a loss of \$70 000. The saving is therefore not the 10 percent interest cost but an amount reduced by the loss on repurchase - the net saving will equate to the current market interest rate of 6 percent.

The table shows that a variation of one percent below or above the projected rate for 2000-01 of 5.39 percent will change the estimated interest saving down or up \$49 million reflecting the magnitude of the proceeds.

The following chart highlights the potential variation in estimated interest savings set out in the previous table.



3.3 ESTIMATED INTEREST SAVINGS FOR THE NON-COMMERCIAL AND COMMERCIAL SECTORS AND THE 2000-01 BUDGET

It is important to emphasise that interest savings calculations for the non-financial public sector vary from the Budget estimates as the budget covers only the non-commercial sector.

Net interest payments to the private sector reflect the current interest costs on external borrowings less earnings on external investments.

Interest payments in the Budget predominantly reflect net payments by the non-commercial sector to the South Australian Government Financing Authority (SAFA) on borrowings from SAFA.

The composition of the non-commercial sector interest payments changes due to reductions in debt as retirement occurs but also due to increases in debt from the transfer of debt from the electricity entities to the Treasurer. The following shows the difference.

Estimated 2001-02 Interest Savings Adjusting for the Market Value of Retained Debt

	Amount \$'million	Interest Rate Percent	Interest \$'million
Net proceeds	4 898.5	5.39	264.0
Less: Debt retained	1 005.0	5.39	54.2
Proceeds less debt retained	3893.5	5.39	209.8

As discussed earlier, debt retained by the Government is at book values. To determine the net saving, however, it is necessary to adjust for the market value, as savings are determined on a market value basis.

It is also relevant to note that a one percent change in interest rates up or down will result in a change of \$39 million up or down to the interest savings figure for the non-commercial sector.

3.4 ESTIMATED INTEREST SAVINGS FOR THE 2000-01 BUDGET

Interest savings in relation to the proceeds have been estimated in the Budget as \$210 million. It is important to acknowledge that the basis for the Budget estimate did not take into account all asset disposals, as they could not be reasonably estimated at the time of the Budget preparation given the disposal process was ongoing. The key variances between the Budget estimate and the final position after asset disposals have been completed are that the Budget estimate was based on a net proceeds estimate of \$3 billion (after adjusting down for retained debt), no allowance was made for proceeds from the disposal of Flinders Power, ElectraNet SA and Terra Gas trader, and the projected interest rate for the 2000-01 financial year was seven percent.

Data now available indicate that total net proceeds (after adjustment for retained debt) are much higher at \$3.9 billion but that interest rates are considerably lower, with the net effect being that the estimated interest savings is virtually the same as the Budget estimate after taking into account the proceeds of all disposals and the reduction in interest rates.

With the passage of time it will be possible to assess the actual savings based on actual interest rates as indicated previously.

3.5 CONCLUSION ON ESTIMATED INTEREST SAVINGS

The estimates of savings herein reflect projected interest rates for forward periods. Changes from the projected rates will result in changes to the estimated savings.

Estimated interest savings for the non-financial public sector (excluding the effect of retained electricity entity debt) to 30 June 2001 arising from electricity asset disposals are expected to amount to \$261.4 million. It is estimated that savings in 2001-02 (ie a full year) will be \$264 million.

Estimated interest savings for the Budget (non-commercial) sector (including the effect of retained electricity entity debt) in 2001-02 (ie a full year) are about \$210 million.

PART 4

EFFECT OF THE DISPOSALS ON THE PUBLIC FINANCES

4.1 INTRODUCTION

The disposal of the electricity businesses affects the State's finances and financial position in a number of ways. These may be categorised as:

- Structural change in financial position.
- Change in operating results.
- Presentational change in financial position.

These are considered in turn.

4.2 STRUCTURE OF THE STATE'S FINANCIAL POSITION

The key reason given for the disposal of assets was to restructure the State's financial position and specifically to reduce risk associated with previous levels of debt (particularly outright interest rate risk) and with operating businesses in the market place. With the finalisation of the electricity businesses disposal program, debt has been reduced by \$4.9 billion. Following the announcement of the first electricity asset disposals in December 1999, the State achieved an improved credit rating of AA+.

Previous Reports have discussed a range of risks associated with operating electricity businesses in a competitive National Electricity Market. The risks of competing in that environment with the subsequent risks to revenues and profits, are avoided but the offset is that the opportunity to earn revenues and profits is also eliminated and the State has a limited own source revenue raising base.

Ownership of assets operating in a competitive environment ultimately requires an assessment and management of risks and returns. The State has avoided this risk through the disposal process.

4.3 CHANGE IN THE STATE PUBLIC SECTOR OPERATING RESULT

4.3.1 Net Benefit from Electricity Asset Disposals

As stated in the past three Auditor-General's Annual Reports to Parliament, a premium from electricity assets disposals of \$100 million was built into the forward estimates in the 1998-99 Budget. A net benefit from completed electricity assets disposals was estimated in the 2000-01 Budget as \$109 million for 2000-01.⁸ This net benefit was determined as the

⁸ Budget Statement 2000-01, Budget Paper 2, p 2.10.

difference between estimated interest savings of \$210 million as discussed previously and dividends, taxes, other distributions etc foregone in that year, estimated to be \$101 million. Revenue estimates were later revised down to \$94 million and the premium revised up to \$115 million. The estimation of a premium is inherently difficult due to fluctuations in interest rates and the subjectivity of forward revenue estimates.

Comments were made in Part 3 of this Report on the estimated 2000-01 Budget interest savings that indicate that estimated interest savings of the order of \$210 million could be made and therefore the estimated premium for 2000-01 is achievable although with substantial underlying changes to the component parts (disposal proceeds and interest rates).

In the longer term, in relation to revenues foregone, in determining the estimate of \$101 million for 2000-01 not all of the entities subject to disposal were included, that is, no revenues were included in respect to ElectraNet SA, Flinders Power and Terra Gas trader.

The 2000-01 Budget indicates that distributions from the entities that remained to be sold were expected to be in the order of \$50 million per year through the forward estimate period to 2003-04.⁹ I have observed that it is currently necessary for the entire disposal proceeds to be taken into account to achieve the Budget estimated interest savings.

It can be surmised that under current interest rate projections, interest savings arising from the disposal proceeds for electricity businesses disposed of since 30 June 2000 do not also cover the revenues foregone from those electricity businesses disposals. Interest savings greater than \$210 million cannot be generated without a higher interest rate climate.

The lower interest rate environment is, however, relevant to all of the State's remaining net debt. After allowing for the final disposal proceeds received since 30 June 2000 of some \$1.2 billion, net debt might be in the order of \$3 billion¹⁰ on which savings will be earned.

4.3.2 Past Contributions from Electricity Businesses

Given the unavailability of forward estimates for all the past electricity entities, the following repeats some historic information presented in my 1999-2000 Annual Report to Parliament, updated as relevant, to provide a perspective to the changes that have occurred over recent years in relation to the public sector electricity industry.

It is of interest to note past contributions received from the electricity businesses in the period 1995-96 to 1998-99 (ie before asset disposals commenced) as credited to the Consolidated Account or otherwise met by those businesses. The following summarises the position.

⁹ Budget Statement 2000-01, Budget Paper 2, Table 5.9.

¹⁰ Net debt of the non-financial public sector at 30 June 2000 was \$4355 million.

Receipts to the Consolidated Account comprised dividends, taxation equivalents and a Statutory Sales Levy that was in place until 1997-98. Interest expense is the servicing costs associated with debt allocated to the electricity businesses at different times met by the electricity businesses. At the time the Statutory Sales Levy ceased, debt restructuring resulted in additional debt servicing costs being met by the electricity businesses to offset the loss of the Levy revenue to the Budget that is, to ensure the change was Budget neutral.

Past Contributions from Electricity Businesses

Year	Consolidated Account Amounts \$'million	Interest Expense \$'million	Total Amount \$'million
1995-96	235.8	36.3	272.1
1996-97	212.2	71.9	284.1
1997-98	273.3	83.9	357.2
1998-99 (a)	172.0	85.9	257.9

(a) 1998-99 was the last full year that the electricity businesses were government owned

The actual receipts varied from year to year with a peak in 1997-98 when the dividend included \$77 million arising from a one-off settlement of an Interconnection Operating Agreement. Other variations from year to year reflect changes in business factors and the Government's dividend policy.

The electricity industry restructuring and disposal processes influence data for the periods 1999-2000 and 2000-01. With the transfer of the electricity businesses to the private sector, no data is available from 2001-02. As a consequence data comparable to that in the table is not available.

4.4 PRESENTATIONAL CHANGE IN FINANCIAL POSITION

The Whole-of-Government Statement of Financial Position as at 30 June 2000 showed total net assets for the State of \$11.9 billion (\$10.5 billion at 30 June 1999). The change in net assets from the previous year is due mainly to a net gain (book profit) on disposal of the net assets of the electricity businesses completed to 30 June 2000, determined as \$1.1 billion.

The following table estimates the net gain arising for the completed electricity assets disposals as at 28 February 2001. The proceeds in the table are net of certain costs and exclude proceeds from operating leases.

Net Gain Arising for the Completed Electricity Assets Disposals

Entity (a)	Proceeds \$'million	Book Value of Net Assets \$'million	Book Profit on Disposal \$'million
RESI Utilities Pty Ltd	184.4	148.1	36.3
Distribution Lessor Corporation	2 704.3	2 069.6	634.7
RESI Power Pty Ltd	161.7	(5.7)	167.4
RESI OE Pty Ltd	7.5	(2.2)	9.7
RESI SYN Pty Ltd	(0.2)	(2.0)	1.8
Generation Lessor Corporation (Optima Energy Pty Ltd and Synergen Pty Ltd)	315.1	116.9	198.2
Flinders Power Pty Ltd	21.3	(13.4)	34.7
Transmission Lessor Corporation	750.9	699.9	51.0
Terra Gas trader Pty Ltd	32.7	19.7	13.0
Generation Lessor Corporation (Flinders Power Pty Ltd)	279.1	124.9	154.2
Total	4 456.8	3 155.8	1 301.0

(a) Entity names as at 30 June 2000

In addition, proceeds of \$432.3 million were received with respect to future operating leases rentals relating to land with a book value of \$44.7 million. The lease revenue will be brought to account over the life of the lease.

As can be seen from the table, the change in the recorded net asset position of the State is a gain of \$1.3 billion. The amounts previously referred to in relation to retained liabilities will not affect the Statement of Financial Position as they are internal transfers between government entities.

4.5 TREASURER'S INDEBTEDNESS

The previous commentary has identified the amounts available for and applied to debt retirement.

Within the public sector, indebtedness of the Treasurer to SAFA is reported in the Treasurer's Financial Statements in Statements I (Indebtedness of the Treasurer) and J (Financial Relationships and Transactions between the Treasurer and SAFA).

The following table summarises changes in the Treasurer's indebtedness for the 1999-2000 year and 2000-01 to 31 December 2000:

Changes in the Treasurer's Indebtedness (a)

	1999-2000 \$'million	1 July 2000 to 31 December 2000 \$'million	Over Whole Period \$'million
Opening balance	7 248	5 853	7 248
<i>Add:</i> Consolidated Account borrowing in year	218	1	219
Assumption of electricity entity debt	620	306	926
SAFA book gains/losses (net)	187	28	215
<i>Less:</i> Repayment of borrowings	2 410	2 525	4 935
Other minor adjustments (net)	10	9	19
Net Decrease	(1 395)	(2 199)	(3 594)
Closing Balance	(5 853)	3 654	3 654

(a) This estimate differs from estimates of public sector net debt provided elsewhere in this Report as it refers only to the gross debt of the Treasurer to SAFA. Net public sector debt includes the net debt of all non-financial public sector entities, and has financial assets offset against the gross debt to derive net debt.

The repayment of borrowings and the retained electricity entity debt discussed earlier in this Report are evident in the table.

The other addition to the Treasurer's Indebtedness of relevance in this commentary is the amount of \$215 million (rounded) SAFA book gains/losses. As disclosed in SAFA's annual financial statements and Statement J, book gains/losses incurred by SAFA from debt management transactions are recovered through an adjustment to the Treasurer's debt level. In summary, the book losses are associated with the unwinding of existing debt and derivatives as a consequence of the receipt of proceeds from the disposal of the electricity businesses. The book losses reflect the realisation of differences between the historical cost of borrowings and derivatives and current market values.

The receipt of the very large disposal proceeds would have caused an increase in the average age (duration) of State debt in contravention of the Treasurer's approved existing debt management policy. To comply with the policy requirements, SAFA entered into financial transactions to hedge the proceeds. As debt matured or was retired early, and the debt portfolio restructured, SAFA progressively unwound this and other deals to remain within the approved policy. This restructuring process required the realisation of existing book losses reflecting differences between book values and market values.

4.6 DID THE STATE RECEIVE A FAIR PRICE?

With the uncertainty that goes with disposing of assets in a newly operating competitive market, it is difficult to conclude with accuracy on the net effect on the State's finances and

in relation to the fairness of the prices received for the government-owned electricity businesses.

In the disposal process, procedures were aimed to achieve the best price by restructuring agencies to enhance their value to a purchaser and maximising competition in the bidding process. The State also determined a range of values that it considered a fair value for the businesses. The principal objectives of the disposal process, as outlined in the Bidding Rules, were to maximise the proceeds available to reduce State debt and minimise the State's exposure to the risks of participating in the electricity supply industry following the introduction of the National Electricity Market.

4.6.1 Business Valuations

In each of the electricity businesses disposals, ranges of values were established by the Government's Lead Advisers based on discounted cash flow analysis prior to the opening of final bids. The analysis estimated the value of the businesses. As with any such valuation, they were derived using a range of discount rates reflecting the risks of operating the assets in the private sector and making relevant assumptions on the underlying revenues. These valuations were advised to Cabinet at the time of seeking approval to enter into lease/sale agreements.

The proceeds achieved were within or exceeded those ranges for all but one of the smallest disposals. In relation to the one disposal, the final bid was below the minimum in the valuation range but this had very little influence on the overall proceeds. In that case the Evaluation Committee examined whether the State was justified in disposing of the business. Ultimately the bid was accepted by the Treasurer on advice that it was the best available price offered in a competitive process and in accordance with the State's benchmark risk position.

Overall, the total cash proceeds received, excluding stamp duty, exceeded the upper limit of the total estimated valuations of the assets.

4.7 CONCLUSIONS ON THE EFFECT OF THE DISPOSALS ON THE PUBLIC FINANCES

4.7.1 Reduction of Risk Exposure

The Government has, by reducing debt, reduced debt management related risks and in particular outright interest rate risk. Following the announcement of the first electricity asset disposals in December 1999, the State achieved an improved credit rating of AA+. The Government has also reduced its risk exposure to operating businesses in the National Electricity Market by the disposal of the electricity businesses. This is offset by eliminating the opportunity to earn revenues and profits in that market and reducing the State's limited own source revenue base.

4.7.2 Net Benefit from Electricity Asset Disposals

The estimated net benefit or premium on disposal of electricity assets to 30 June 2000 was \$115 million of which \$100 million had been built into the forward estimates in the 1998-99 Budget. This estimate excluded the effects of any disposals completed in 2000-01.

The data currently available indicates that the premium is achievable albeit based on the total proceeds for the disposal of all electricity businesses and lower interest rates than were initially estimated.

4.7.3 The Accounting Gain

The accounting gain from the disposals was \$1301 million reflecting the receipt of proceeds of \$4457 million for assets with a net book value of \$3156 million. In addition, proceeds of \$432.3 million were received with respect to future operating lease rentals relating to land with a book value of \$44.7 million.

4.7.4 Net Reduction in the Treasurer's Indebtedness

For the non-commercial sector, the net reduction in indebtedness of the Treasurer, which is the base for net interest payments in the Budget, over the period for 1999-2000 and 2000-01 to 28 February 2001, was \$3594 million.

4.7.5 The Matter of Whether a Fair Price was Received

It is not possible for Audit to form an opinion in relation to the fairness of the prices received for the government-owned electricity businesses.

However, information provided to Cabinet on the valuation of assets by the Government's Lead Advisers before each disposal, indicated that, overall, the total cash proceeds received, excluding stamp duty, exceeded the upper limit of the total estimated valuations of the assets.

PART 5

COMMENTARY ON THE PROBITY OF THE DISPOSAL PROCESS

5.1 INTRODUCTION

The Audit review of the probity of the disposal process for the government-owned electricity assets was conducted in the following manner.

5.1.1 Scope of the Audit

The Audit review of the probity of the processes leading up to the disposal of each government-owned electricity business involved an assessment of whether:

- an appropriate process for the conduct of the disposal process has been developed, which takes into account the issues likely to arise during the process and dealing with those issues in a way which minimises the risk to the Government;
- the process so developed was adhered to in the conduct of the disposal process;
- all issues that may give rise to liability on the part of the Government have been identified and dealt with in a proper manner.

In a previous Report on the arrangements for the probity audit,¹¹ I described the need to develop a clearly articulated and objective model for the proper conduct of the disposal process. I also described what were, in my opinion, the minimum requirements for this model, also known as a probity plan and, observed that the plan needs to be developed on the basis of clearly articulated probity principles. In my opinion the following principles were relevant to the disposal process for the electricity entities:

- To ensure that a defensible yet flexible and objective tender and evaluation methodology/strategy is established.
- To ensure that the need to avoid inherent bias in the process is taken into account when making decisions that may impact on the process. This includes matters such as decisions as to the regulatory regime to apply down to decisions as to how to advertise and market the disposal.
- To ensure the probity of the selection process for the engagement of all advisers.
- To ensure that an effective process to protect/secure all confidential information is established.
- To establish and promulgate guidelines with respect to probity issues including conflicts of interest, fair dealing etc.

¹¹ Supplementary Report of the Auditor-General on 'Electricity Businesses Disposal Process in South Australia: Arrangements for the Probity Audit and Other Matters: Some Audit Observations' dated 28 October 1999.

- To take action to address all conflicts of interest issues as and when they might arise.
- To ensure compliance with obligations regarding consultation with affected employees and their representative organisations.
- To ensure that all bidders are treated fairly and equitably consistent with the rules of natural justice and procedural fairness.
- To ensure appropriate probity and security checks are carried out in respect of shortlisted bidders.
- To minimise potential liability that might otherwise arise out of the conduct of the tender process.
- To ensure effective contract risk management arrangements.
- To ensure a clear audit trail.

5.1.2 Audit Approach

In the course of discharging my independent audit responsibilities, I have had to determine the extent to which reliance may be placed upon the work of experts. This is then supplemented with whatever substantive audit procedures are deemed necessary to provide for the evidentiary basis upon which an audit opinion can be expressed.

In assessing the extent of the reliance to be placed on an expert, I have had regard, inter alia, to the following matters:

- Evaluation of the experience and technical competence of the expert upon whom reliance is to be placed with respect to the particular subject matter involved.
- The scope of the work undertaken by experts and whether any scope limitation has the potential to have a material impact on the opinions expressed by them.
- Separate and apart from the matter of 'scope' it is important to assess the purpose for which the expert has been engaged and whether that purpose is relevant in the context of the responsibilities of the Auditor-General.
- The operative professional and/or other standards that are the basis for the activities being undertaken by the expert.
- The availability of adequate working papers and other documentation maintained by the expert to support the opinions and conclusions that may be expressed.
- The degree of independence/objectivity of the expert having regard to the terms of engagement, and any previous association of the expert with the entity.
- The credibility of the information upon which the expert based any opinions or conclusions.

Of particular relevance to my obligations under the Disposal Act was the work of the Probity Auditor given the scope and nature of his work, and his independence from the day-to-day management of the disposal process by the ERSU.

In preparing this Report I have sought not to duplicate the processes or activities undertaken by the appointed Probity Auditor. I have instead reviewed the reports and memoranda prepared by the Probity Auditor to the Treasurer, and, where I have deemed it necessary because of the scope of the Probity Auditor's work, nature of the issue, or its potential sensitivity or impact upon the probity of the disposal process, I have conducted my own independent inquiries/review.

I have also obtained from the Probity Auditor a confirmation as to his satisfaction (within the parameters of his contractual obligation to report to the Treasurer) with the probity of the disposal process.

The assistance provided to Audit by the Probity Auditor during the course of the disposal process is acknowledged.

Throughout the course of the disposal process I have been cognisant of the need for Audit to remain independent of the disposal process. As a result, I have sought not to actively participate at any direct level in the actual processes undertaken by the ERSU, for instance, through attendance at internal Committee Meetings held by the ERSU with its various advisers throughout the disposal process.

My approach in dealing with the ERSU and its advisers has been as follows:

- Throughout the disposal process the ERSU has provided me, on a regular basis, with copies of all internal Committee Minutes.
- Where I have deemed it necessary, I have requested the ERSU to make available to me the documentation/files held by them in relation to specific matters. This has taken the form of specific documentary requests. The ERSU has either responded by providing me with a copy of the requested documents or alternatively by making files available to me for review (and subsequent copying where deemed necessary).
- In the circumstances where I have had the need to seek clarification on the documents or files I have reviewed, my practice has been to put questions to the ERSU in writing. Generally the ERSU has also responded to these questions in writing usually with attachments. On occasions I have met with officers of the ERSU in order to further clarify a particular issue or request.
- It has been my practice throughout the disposal process to provide to the ERSU Issues Papers for comment in relation to any areas of concern that I have identified in the course of my review.
- Upon receipt and consideration of the response by the ERSU to these Issues Papers it has also been my practice, in accordance with the mandate provided to me by subsection 36(3) of the *Public Finance and Audit Act 1987*, to issue separate Supplementary Reports to Parliament.

This Report draws upon the issues identified in those prior Supplementary Reports.

In order to assist me in preparing reports on the disposal process I also retained the services of the Australian Government Solicitor (AGS) to provide expert advice and analysis on issues referred to them by me during the course of my review within their sphere of expertise. In deciding to engage the services of AGS I had regard to the extensive experience of their nominated personnel in providing legal services to government in similar disposal processes, their independence from the process and lack of conflicts of interests, the availability of their personnel and the availability of similar expertise in the market.

5.2 ISSUES FROM PREVIOUS REPORTS

In previous Reports¹² I identified major issues that, in my opinion, represent deficiencies in the process that, if repeated in future asset disposals, could lead to probity issues arising. These major issues have been included in this Part of the Report for completeness. A number of other process issues related to the probity of the disposal process are also detailed in the previous Reports.

5.2.1 Obligation for Procedural Fairness

I have expressed the view¹³ that the approach adopted by the ERSU for the electricity businesses disposal process has been to create a process contract between the Treasurer and each bidder participating in that process. The terms of the process contract are the Bidding Rules established by the Treasurer for each disposal. The Bidding Rules for each process contained statements that could lead a bidder to believe the Treasurer would exhibit fair dealing in the performance of the process contract.

Initially the view expressed by the ERSU regarding the implications of a process contract was fundamentally at variance with the view expressed by me. The ERSU view is demonstrated by the following statement:

There is no explicit promise that the process, in all circumstances, will be fair. Consequently we contend that it is open to a Court to make a finding that a term as to fairness of process would not be implied. We accept that the Auditor-General may have a different view on this issue.

It is clear from this statement that the ERSU was of opinion that the Treasurer could, as a matter of law, contract out of an obligation to ensure procedural fairness. In my opinion, the holding of such a position by a body/person exercising public functions where the rights and/or legitimate expectations of individual or corporate members of the community may be

¹² Refer to list of Reports set out in this Report under the heading '1.2 — Audit Mandate'.

¹³ 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, p 26.

adversely affected, is untenable, probably, given the process adopted by the ERSU, as a matter of law, but certainly as a matter of public policy. The fact the ERSU and the Treasurer held this view, even though they may state that as a matter of practice they intend to act in a manner that accords procedural fairness to all bidders, in my opinion, raised serious concerns regarding the arrangements that underpinned the decision-making processes within the ERSU and by the Treasurer.

In fact, following the preparation of my Report indicating concern with the ERSU position, the Treasurer obtained advice from Senior Counsel that supported my expressed view.

5.2.2 Information Gathering

In relation to the due diligence process, I have previously commented¹⁴ on the processes for the gathering of information (undertaking due diligence) in relation to the electricity entities on behalf of the State and the dissemination of information concerning those entities to bidders for the ultimate purpose of submitting final bids for an interest in the electricity entities. With respect to those processes, issues were identified relating to the:

- absence of a documented record to indicate that the State's Advisers have comprehensively advised the committees appointed by the State to conduct the due diligence process and to prepare the Information Memoranda as to the risks of litigation or challenge by bidders arising from the processes;
- inclusion in the Planning Memoranda for the information gathering process of a range of assumptions and an indemnity to the State's Advisers, the effect of which is that the State's Advisers have no liability to the State if they conduct their due diligence work in accordance with the processes outlined in the applicable Memoranda;
- absence of sufficient comfort from the State's Advisers that the processes conducted by them as outlined in the Planning Memoranda affords the State with any protection in the event of a challenge by bidders.

In my opinion, the implication of these issues is that the State is required to accept full responsibility for the information gathering and dissemination processes that its Advisers recommended it adopt, without any apparent clear documented understanding as to the risks associated with adopting those processes and any comfort as to whether those processes would afford it any protection in the event of a challenge by bidders. As a consequence of these arrangements (and in particular flowing from the provisions of the Planning Memoranda) the State's Advisers are, in my opinion, accountable to the State only in respect to their role in the conduct of the disposal process, the appropriateness and effectiveness of which was not transparently addressed.

¹⁴ 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, p 62.

5.2.3 Final Bid Process Issues

I have previously identified¹⁵ a number of issues associated with the process adopted by the ERSU in its preparations for, and the conduct of, the evaluation of the Final Bids.

5.2.3.1 Evaluation Methodology

Of particular concern was the process for the consideration and settling of material aspects of the evaluation methodology for the ETSA Utilities and ETSA Power Final Bid process. In my opinion, the failure by the ERSU and the Evaluation Committee to develop and settle the guidelines necessary for the conduct of the evaluation until the last days of the bid evaluation gave rise to unnecessary risks to the State in the conduct of the disposal process and in such circumstances cannot be said to be consistent with the requirements of good administrative practice. To develop or finalise an evaluation methodology during the evaluation of bids, in particular any aspect of that methodology which may materially affect the evaluation outcome, may result in an inconsistent and possibly an indefensible result. If the time allowed for conducting the evaluation is short, the risks resulting from settling the methodology concurrently with the evaluation of bids will be increased. I note this was an aspect that was significantly improved upon in the conduct of the later disposal processes.

5.2.3.2 Eliciting Further Bids

Following receipt of Final Bids for ETSA Utilities and ETSA Power it was decided that in order to improve the terms of the Final Bids on both price and risk, negotiations should be commenced with each bidder. A set of 'negotiation protocols' was established to govern this process.

The conduct of these further negotiations on price and risk in this way was not, in my opinion, specifically contemplated in the Bidding Rules agreed to by the Bidders to cover the disposal process.

In my opinion, Bidders had a legitimate expectation that if the Government decided not to accept any of the Final Bids it received, and intended to seek further bids from all or some of the bidders, it would follow the process in the Bidding Rules for inviting such bids. During the review of the disposal process for ETSA Utilities and ETSA Power, however, I found no evidence that, having regard to the advice obtained at the time, that the ERSU and the Evaluation Committee fully analysed the risks associated with the adoption by the Government of 'negotiation protocols' intended to elicit improved bids on 'risk' and 'price', which was not contemplated in the Bidding Rules.

¹⁵ 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, pp 89-108.

5.2.3.3 Accountability of Advisers

The procedures adopted by the ERSU to manage the appointed advisers to the disposal process have, in my opinion, led in part to key advisers not being held to be fully accountable to the State for the Project Documentation. The management arrangements that have been adopted by the ERSU have involved the establishment of a comprehensive committee structure comprising representatives of the Lead, Legal and Accounting advisers and the ERSU. Whilst this committee structure has facilitated an open exchange of views, in my opinion, it has also had the indirect effect of diluting the accountability of these advisers to the State. In a transaction of such importance, I understand that it is common practice to require the advisers with principal responsibility for the preparation of the Project Documentation (the Lead, Legal and Accounting advisers) to provide to the State, prior to execution of the Project Documentation, a sign-off that confirms that the final form of the Project Documentation:

- fully complies with and gives effect to the instructions received by the advisers from the State during the course of the disposal process;
- is fully consistent with all regulatory and legislative requirements;
- appropriately protects the State from potential liability.

The ERSU, however, did not require all the advisers with input into the preparation of the Project Documentation to provide a formal sign-off on the final form of the Project Documentation as outlined above.

The accountability of the advisers has in my view also been further diluted by the inclusion of a provision in the Business Sale Agreements whereby the purchasers have agreed not to make and waive any right they may have to make any claim against the Treasurer or any government party (noting that the advisers are covered by the definition of 'government party') arising from a breach of the *Fair Trading Act 1987* and the equivalent legislation in other applicable jurisdictions.

The protection afforded to the advisers under the applicable Business Sale Agreements is a protection from a possible liability arising under statute. This in my view runs contrary to the provisions contained in the advisers' contracts, which required those advisers to comply with the laws in force in South Australia. I am also concerned that the protection applies whether or not the advisers have acted with bad faith or negligently.

In my opinion, there is no objective evidence to show that the advisers agreed to reduce their fees in return for the inclusion of such an undertaking in their favour nor is there any evidence to show that any objective assessment was made of the possible cost to the State in terms of reduced disposal proceeds that the inclusion of this undertaking in favour of the advisers may have given rise to.

5.2.4 Adviser Issues

In a previous Report¹⁶ I set out a number of issues relating to the appointment of advisers for the disposal process.

5.2.4.1 Success Fees

The Consultancy Agreements with the Lead Advisers and the Accounting Adviser to the disposal process provided for the payment of a success fee.

Lead Advisers

The greater the 'degree of risk' to be assumed by the State, the greater is the potential 'price' to be received for the asset and hence, the greater the reward for the Lead Advisers under their success fee arrangement. The analysis of risk to be assumed by the State in the disposal process was made not only against pre-established benchmarks, but also against risks where the benchmarks were determined only after the bids had been received and opened.

In my opinion, in those circumstances where the State was reliant upon the advice of the Lead Advisers regarding acceptance/commerciality of risk, the arrangements established by the ERSU did not reflect sound administrative practice, and in fact, placed the State in a potentially prejudicial position. As a matter of principle, to structure a complex asset disposal process involving the payment of a success fee based on 'price' with the same persons who are entitled to the success fee having a concurrent responsibility to analyse the commercial acceptability of the impact of risks to be assumed by the State arising out of the disposal and to advise on the value of assets being sold is, in my opinion, not only an unsafe administrative arrangement but also inconsistent with good administrative practice.

The pervasive nature of the advice required of the Lead Advisers within the disposal process cannot be said to have been counter-balanced by the influence of other advisers. Although there were other advisers who have specific responsibilities (eg Legal and Accounting Advisers), the Lead Advisers were in a strategic overarching role. The inherent temptation to maximise 'the price' and to not have adequate regard to the issues arising from the assessment of risk is, in my opinion, an unacceptable arrangement. The tendency of the operation of this contractual relationship in these circumstances, particularly in the absence of transparent and effective contract and risk management processes, is such as to be a matter of concern. Based on my review, there is no evidence that the existence of a success fee arrangement affected the advice provided by the Lead Advisers.

¹⁶ Supplementary Report of the Auditor-General on 'Electricity Businesses Disposal Process in South Australia: Engagement of Advisers: Some Audit Observations' dated 28 November 2000.

Accounting Adviser

In contracting the Accounting Adviser, the State also negotiated a 'success fee' (or 'incentive bonus') which could result in the Accounting Adviser receiving payment of a significant amount over and above their daily fees if, for example, disposal proceeds reach \$6 billion. There is no documented rationale as to why it was considered necessary for the State to agree to such a payment.

Given the services to be provided by the Accounting Adviser (which also included the provision of financial restructuring and undertaking due diligence and limited evaluation activities), I am of the opinion that the role played by the Accounting Adviser could not be seen to have actively contributed to the achievement of potentially increased disposal proceeds and hence warrant the payment of a form of incentive bonus.

The ERSU advised Audit that the appointed Accounting Adviser was preferred because of their recent Victorian electricity industry experience. Further, the ERSU considered that the way in which the disaggregation of the electricity businesses was undertaken would be a key to the eventual proceeds from their disposal, and thus the Accounting Advisers could contribute to the overall profitability of the disposal process. The ERSU also commented that through negotiations, the hourly rates were lowered as a trade off for the success fee.

I consider that the incorporation of a success fee reward structure into the contract with the successful Accounting Adviser is, having regard to the role of the Accounting Adviser, inappropriate. Further, I am of the opinion that the use of such a reward mechanism needs to be carefully considered by the State in all future engagements of advisers.

Audit Observation

In my opinion, the payment of a 'success fee' should not have been agreed to, unless it could be demonstrated to be clearly in the best interests of the State, ie the successful adviser was the only firm able to perform the consultancy services to the required standard and would not have contracted without the success fee component.

5.2.4.2 Conflict of Interest

The Consultancy Agreements with the successful advisers all provide that the Treasurer can terminate the Agreement if the consultant has an actual conflict of interest. However, none of the Consultancy Agreements contain a mechanism for dealing with perceived conflicts of interest. Advice from the Chief Commercial Counsel, Crown Solicitor's Office to the ERSU confirmed that unless an adviser has an actual conflict of interest or breaches confidentiality the State can do nothing.

In my opinion, this is a highly unsatisfactory situation. I have previously commented¹⁷ that the perception of a conflict of interest can, unless quickly and adequately resolved, be as damaging to the disposal process as an actual conflict and can found a legal challenge. My opinion that the contracts should have provided for a mechanism by which to manage perceived conflicts of interest is supported by the advice later obtained by the ERSU from a Queen's Counsel in respect of a perceived conflict in relation to the ElectraNet SA process involving the Lead Advisers.

5.3 CONCLUSION ON THE PROBITY OF THE DISPOSAL PROCESS

Based upon the results of my review, I am of the opinion that although there are a number of matters I have identified that had the potential to undermine the probity of the disposal processes (including the process leading up to the making of each relevant long term lease), nothing has come to my attention to cause me to believe, and I do not believe, that these matters have in substantive terms affected the probity of the overall disposal process.

Having formed that opinion, the matters I have identified and discussed in this Part of the Report, do, in my opinion, represent deficiencies in the processes which, if repeated in future asset disposals, could lead to a probity issue arising.

In reaching this conclusion, it is relevant to note that the processes adopted for the disposal of the individual businesses did, in my opinion, improve significantly from a probity perspective as the disposal process proceeded for the respective businesses. The major issues commented on in this Part of the Report were largely related to the initial design of the overall disposal process, and the specific arrangements adopted for the disposal of ETSA Utilities and ETSA Power.

I also recognise that in some instances, the approach adopted for the conduct of the disposal process reflected the commercial judgement of those charged with responsibility for managing that process. I also acknowledge, that it is quite legitimate for differences to exist in relation to the approach to commercial issues. The matters commented on in this Report however reflect my view regarding the principles of probity, accountability, transparency and auditability, which should, in my opinion, always be the basis upon which governmental activities are carried out.

5.4 ONGOING CONTRACT MANAGEMENT

My review indicates that there is a considerable requirement for on-going contract management by both the Crown, the Distribution Lessor Corporation, the Generator Lessor Corporation and the Transmission Lessor Corporation under the Project Documentation for the disposal of the prescribed electricity assets.

¹⁷ Supplementary Report of the Auditor-General on 'Electricity Businesses Disposal Process in South Australia: Engagement of Advisers: Some Audit Observations' dated 28 November 2000, p 40.

In my opinion, it is appropriate that a complete assessment be undertaken of these ongoing management requirements so as to ensure that these requirements are appropriately addressed and that responsibility for these requirements is allocated appropriately. I understand that it is normal practice for advisers on asset disposals such as that for the electricity businesses to prepare a detailed procedure manual setting out these ongoing management responsibilities so as to assist with future contract administration. This manual should, in my opinion, be prepared concurrently with the finalisation and execution of the Project Documentation for the disposal of each of the electricity businesses.

The ERSU has advised that first drafts of these manuals were received by the Department of Treasury and Finance from a member of the Legal Consortium on 11 January 2001.

The matter of ongoing contract management will be monitored in the normal course of audit activity during the 2000-2001 financial year.