

Public sector insights

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Dear friends

Welcome to this edition of *Public sector insights*. Since the last edition, the Australian and New Zealand governments continue their significant efforts in restoring growth and stabilising the economy. This has included an increased focus on regulation, working with the financial markets and a heightened level of infrastructure investment. Government departments are also under pressure to deliver more with less given the current fiscal situation.

Given these circumstances, we are seeing the role of government continually evolving. Governments need to be at the forefront of the complex issues of today. They need to have the courage to implement serious structural change and well considered policy reform whilst building confidence in the economy and financial markets. Our message to government is *"Don't prepare for the world as it is, prepare for the world as it's going to be."*

Our headline article focuses on financial regulatory reform and structural reform initiatives and the collective actions taken to stabilise the world economy and restore growth.

My colleagues and I in Ernst & Young's Oceania Government and Public Sector team hope this edition provides you with ideas and inspiration. The Government and Public Sector team's contact details are on the back page for your reference. Feel free to contact us directly any time.

Best regards



Uschi Schreiber

Oceania Managing Partner,
Government and Public Sector
uschi.schreiber@au.ey.com
Mobile: +61 408 742 686

Don't prepare for the world as it is but as it will be

Responding to the financial crisis and beyond.
A public sector perspective.

The Global Financial Crisis (GFC) presents an opportunity for governments to build a resilient and robust economy and a greater understanding of the real issues facing the financial industry. As a result of years of micro-economic reforms, the Australian government is well positioned to respond to the unique issues of the financial crisis. This is helped by increased collaboration between State and Federal governments under the Rudd government. Given our current system has held up well following the significant reforms of the 1990s, it is not yet clear how much regulatory change is required or how much global regulatory change will impact Australia. One thing is certain - the emerging issues can not afford to be politicised.

Instead, government needs to think innovatively in its structural reform response to the financial crisis to ensure longer term economic benefits and to make Australia a more productive economy. It used to be said that recessions drive policy innovation. It remains to be seen what the new policy paradigm might look like. However, it is apparent that there will be structural reform in the public sector as a significant part of governments' response.

Over the last six months, we have seen the Australian government act swiftly and mobilise efficiently to respond to the broader liquidity issues in the market. This has been part of a global trend that has had some significant implications on G20 including the Finance Ministers endorsing the proposed Financial Stability Board principles for executive remuneration¹.

Financial regulatory reform initiatives around the world continue to move at a rapid pace. Recently, both the EU Council of Ministers and the US Administration proposed significant reform measures, including the creation of a systemic risk regulator in each jurisdiction and other measures to close gaps in regulation that are perceived as having contributed to the financial crisis. These developments are notable not only for the potential impact they could have in the EU and US markets, but also for their global implications.

"We don't want to stifle innovation but I'm convinced that by setting out clear rules of the road and ensuring transparency and fair dealing, we will actually promote a more vibrant market. This principle is at the heart of the changes we're proposing."

Barack Obama
President, United States of America²

What does this mean for governments in Australia?

As a result of previous reform agendas and increased collaboration between States and Federal government, Australia is well positioned to respond to pervasive issues such as the recent financial crisis. It is not yet clear the degree of regulatory changes required as a result of the crisis given our current system has held up well following the reforms to the financial industry in the 1990s.

However, it is anticipated that the emerging impact of the financial crisis on government departments will be on structural reform to retain costs and enhance efficiencies. The current crisis has led to significantly reduced tax revenue which creates even greater need to do more with less. The public sector is under more pressure now than ever before with decreasing service delivery budgets and high constituency expectations.

This comes on top of pre-crisis agenda items including the ageing population, climate change and chronic disease.

Government has taken certain actions to support investment and economic development. The emphasis now needs to shift from stabilisation measures to rebuilding the future and we have seen evidence of this through the Infrastructure Australia plan. The short-term measures of the stimulus package focus on social housing construction, subsidies to companies and reduced red tape, energy efficiency measures and significant investment in education and transport infrastructure. While we have seen further moves to quickly develop programs such as the Nation Building and Jobs Plan, or small business initiatives such as tax breaks for new capital expenditure, more may be required.

"The government's got no intention of slowing down on its reform agenda. It's true the global recession makes reform harder at one level. But it also makes it even more vital - we inherited an inefficient, wasteful and disorganised public sector."

Lindsay Tanner,
Australian Finance Minister³

**For more information or to discuss further, please contact Tim Coyne
Tel: +61 3 9288 8056**

¹ FSF Principles for Sound Compensation Practices, Financial Stability Forum, 2 April 2009

² Quoted in 'Obama rewrites the rules on risk' *The Australian Financial Review*, Tony Walker and Robert Guy, 19 June 2009

³ Address to the National Press Club of Australia, The Hon Lindsay Tanner, MP - Minister for Finance and Deregulation, Canberra, 11 March 2009

The hare and the tortoise

Infrastructure implementation planning

While speed of delivery in infrastructure projects is essential to achieving economic stimulus objectives, this should not occur at the expense of achieving long term objectives.

Infrastructure Australia has set out a significant program for the delivery of infrastructure across Australia to deliver future prosperity. It is a welcomed initiative for Australia's long-term, coordinated national approach to infrastructure planning and investment. Whilst there is a need for speed in delivering the projects to ensure it stimulates the economy and creates jobs, it needs to be combined with effective implementation planning at the front end to prevent longer term cost and risk implications.

To focus only on fast spending now could potentially ignore the more fundamental issues of implementing appropriate procurement planning processes and robust governance regimes. This is required to ensure that all projects that have been selected achieve the desired Nation Building outcomes for future generations of Australia.

A significant amount of the project cost is in the initial construction. After the initial set-up, proper planning is critical to ensure the bulk of the infrastructure costs are not blown out by changing deadlines and altering the scope of the project. The costs required for ongoing maintenance of the projects needs to be quantified as part of the upfront planning to ensure Australia is not left with white elephants post the current infrastructure spending.

How to ensure effective implementation planning

There are key components of the planning phase that are critical for the project to be effective. The detail required in each step will vary with the type of project.

1. Confirm service outcomes

All of the relevant stakeholders need to share the vision of the desired outcomes for success. This can be a challenging exercise for large projects where stakeholder alignment might be difficult to achieve, particularly if it's under pressure from tight deadlines.

2. Project design and planning

Planning needs to be outcome-focused and align to the long-term objectives and design framework.

3. Delivery

The inputs need to be mapped to the outputs of the project. The main players in the project need to understand the relationship between each component.

4. Performance management and monitoring

Implementation should be methodically planned, measured and monitored.

There needs to be a feedback loop to allow for review and refinement of the design framework and project portfolio.

The Federal and State governments have been tasked with the difficult challenge to fund the shortfall in infrastructure spend out of the recent budgets. Beyond the funding gap, attention needs to move to focus on the delivery and planning to ensure the long-term benefits are indeed "Nation Building" for further generations of Australia.

5. Risk management and mitigation

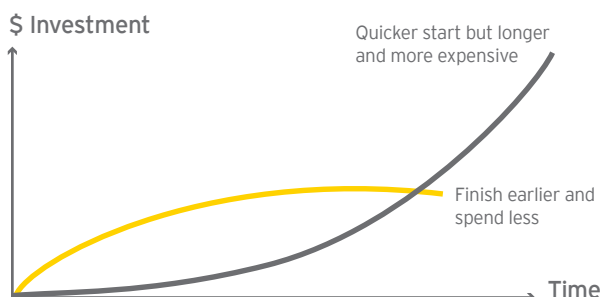
The risks and opportunities in project delivery and how the best value can be achieved needs to be clearly outlined, regardless of what type of project it is.

What are the pitfalls of not doing it properly?

- ▶ Objectives are not clearly defined which means they can be difficult to meet.
- ▶ Inadequate clarity of how new infrastructure contributes to improved service outcomes for the community.
- ▶ The most relevant procurement method may not be identified for the circumstances or could miss potential participants.
- ▶ Increased cost and time in delivery.
- ▶ Too much focus on accelerated delivery can risk the optimisation of whole of life cost.

The procurement and delivery phase needs to be carefully considered. Over the course of the project an accelerated path to getting started might not be the quickest way. After the funding gap is solved, there needs to be a long-term view of the infrastructure development to ensure it delivers all that is intended. The current infrastructure projects are a long awaited and applauded initiative by the government. The plan for the long-term needs to coincide with the investment to ensure Australia's future is secured.

For more information or to discuss further, please contact Bill Banks Tel: +61 2 9248 4522 or John Matthews Tel: +61 3 9288 8830.



Demonstration of cost and time between a well planned project and one that does not have sufficient planning at the start.

Operational efficiency

Can Australia match the UK?

The British government has recently released an ambitious Operational Efficiency Program. The Australian government would need to work together across Federal and State boundaries to achieve parallel scales of efficiency savings to those outlined in the British government's report. Newly announced departmental mergers in New South Wales and Queensland could be steps towards reaching the best potential savings in collaborative procurement, back office operations and IT, locally, and nationally.

United Kingdom

The British Treasury recently published the findings of its year-long study into potential operational efficiency savings across the public sector. The report identified £15 billion annual savings from the following:

- ▶ Back office operations and IT
- ▶ Collaborative procurement
- ▶ Asset management and sales
- ▶ Property
- ▶ Local incentives and empowerment

As part of Spending Review 2004, the Department of Health agreed a target to achieve efficiency savings of at least £6.5 billion in annual efficiencies by 2007/8. This was to be achieved by:

- ▶ Reducing the number of civil service posts in the central department
- ▶ Making better use of staff time - in particular by implementing modern ICT infrastructure
- ▶ Making better use of National Health Service (NHS) buying power at a national level to get better value for money in procurement
- ▶ Ensuring NHS organisations share and rationalise back office services, such as finance, ICT and human resources

At the same time as these efficiency saving targets were announced, it was confirmed that the NHS could expect funding increases of 7.2% above inflation until 2007/8.

These savings would follow on from the UK's 2004 ICT efficiency report, led by Sir Peter Gershon, which delivered £26.5 billion of annual efficiencies by 2008. The annual savings from the Gershon report equate to almost 4% of the British government's total expenses, and the new report identifies a further 2%. All governments globally would aspire to achieve this level of saving in the face of increasing in areas such as health and infrastructure.

Australia

The Australian government has followed the example of the UK by commissioning Sir Peter Gershon to report on potential ICT efficiency savings; his report was released in November 2008, and the recommendations were accepted in full.

If the Australian government continues following the UK's example, and considers a similar operational efficiency program, could the savings here be on a similar level as the UK?

In practice, Australia's federal system of government does not lend itself as readily to operational efficiency as the UK. Although the UK has devolved some powers to the Scottish Parliament, as well as to the Welsh, Northern Irish and London Assemblies, approximately 80% of British government expenditure still relates to central government.

In Australia the Federal government constitutes roughly 33% of total government operating expenditure, with the states, territories and local government making up the rest. One of the keys to Australia-wide operational efficiency, therefore, would be to ensure that state and territory governments are factored into the process.

Collaborative procurement

The British report found that savings are possible through "harnessing the public sector's collective buying power by buying more goods in a collaborative way and driving more procurement spending through collaborative channels".

Differing departmental responsibilities in each state hinder the collaboration suggested by the report, though the announced departmental mergers in New South Wales and Queensland (which will mean that these states have a similar agency structure to each other and other states) will reduce these obstacles.

Back office operations and IT

The British report recommends benchmarking and review of costs to achieve savings. Again, once completed, the departmental mergers in New South Wales and Queensland should create state departments that are more easily comparable, allow better benchmarking and realistic cost reviews across state boundaries.

**For more information or to discuss further, contact Uschi Schreiber
Tel: +61 408 742 686**

Under the hammer

Public sector real estate investment getting the right mix for your asset portfolio

New issues in real estate have arisen as a result of the Global Financial Crisis (GFC), such as difficulties in accessing capital, pricing uncertainty, and sustainability.

In recent times the management of real estate portfolios by the public sector has been under increased pressure. Changing economic forces have resulted in the public sector becoming more aware of their real property assets and how they contribute to the overall health of the organisation. This financially driven spotlight on operational property assets has seen a dramatic shift in the way that these assets are owned, leased and operated. The public sector has led the way in innovative resourcing strategies and adopting new ways of delivering the work environment.

Capital

Accessing capital for real estate transactions is becoming increasingly difficult for any organisation in today's environment. Private companies have the benefit of more funding alternatives and the flexibility of investigating partnering and strategic alliance options. In the public sector context however, real estate transactions must use public funds in the most effective manner to support the delivery of government services. With increased scrutiny on government spending, this is more vital than ever.

Risk

Although the revenue and capital used to fund real estate transactions in the public sector may be reasonably secure, it's important to note that exposure to risk can still be extremely high. It's vital to assess your exposure to risk throughout your entire value chain.

Public sector organisations need to adopt a more competitive mindset in these turbulent times. By conducting due diligence on real estate portfolios, organisations can reduce revenue leakage and identify key risks such as operation cost blow outs. Public sector organisations should also look to implement systematic approaches for managing risk, cutting costs and improving cash management.

Demographics

There are immediate and concerning risks for property transactions in the public sector, including changing demographics. Changing demographic trends determine when and how public funding and services are required to support development. Australia's population, like that of most developed countries, is ageing as a result of sustained low fertility and increasing life expectancy. Over the next several decades, population ageing is expected to have significant implications for Australia including health, labour force participation, housing and demand for skilled labour. This has many implications for the public sector, particularly departments that manage social infrastructure. While the government realigns services to cater for this change in demographics, property and real estate transactions will be driven by the trend and will be modified accordingly, most likely in terms of location, size and composition.

Sustainability

Government departments have led the industry in terms of addressing energy efficient and green buildings with the development and implementation of accommodation guidelines. In doing so, public sector organisations not only promote and reduce carbon dioxide emissions, but also reduce expenditure on energy. Risks for the public sector are centred on maintaining and enhancing current standards rather than initiating the application of new strategies and technologies. Any decrease in standards by public sector organisations, due to the current economic climate would have wider industry ramifications. Sustainability benchmarking would help to prevent potential decreases.

Public sector organisations, particularly large agencies, should undertake risk analysis to understand where their business is exposed to carbon emissions throughout their entire value chain and also align with the appropriate advisors to help move through the "greening" process.

The outlook

In our view, many departments and agencies are doing too little in the area of risk management for their real estate portfolios. No matter what property sector you operate in; residential, commercial, retail or industrial; or what role you play; buyer, seller, lender, borrower; the key to mitigating risk is to understand your operating environment, know your options and have clarity and visibility of the composition of your portfolio.

**For more information or to discuss further, please contact Ross Hamilton
Tel: +61 3 8650 7690**

"It is now more important than ever for public sector organisations to plan for the long term, ensuring that they are linked to the overall direction of government. An ad hoc series of reactive investments and divestment decisions are no longer going to be feasible in the eyes of the public in today's environment"
Ross Hamilton, Partner - Ernst & Young's Real Estate Advisory Services

Exposing the drafts

A public sector accounting update

Income from non-exchange transactions, such as grants, donations, bequests and taxes often dominates the income streams of not-for-profit entities (NFPEs). However, existing accounting standards do not comprehensively address the recognition and measurement issues associated with income from non-exchange transactions and this has led to variations in practice.

The Australian Accounting Standards Board (AASB) and the Financial Reporting Standards Board (FRSB) (the Boards) have finally approved a joint exposure draft (ED) on income from non-exchange transactions with the intention of subsequently issuing common standards. The ED proposes requirements for not-for-profit entities (NFPEs) in Australia and public benefit entities (PBEs) in New Zealand. The ED is based on the International Public Sector Accounting Standard Board's standard, IPSAS 23 Revenue from Non-Exchange Transactions (Taxes and Transfers).

Non-exchange transactions arise when an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange. These include taxes and transfers. The ED proposes that where a transaction is partly an exchange transaction and partly a non-exchange transaction, the transaction is split and the non-exchange component dealt with under the proposed standard.

The proposed standard would require NFPEs/PBEs to account for non-exchange transactions by recognising the inflow of resources (cash or other transfer) as an asset at its fair value or, if a financial asset, in accordance with AASB 139 Financial Instruments Recognition and Measurement. In addition, a liability would be required to be recognised where a present obligation arises from the transfer, measured as the best estimate of the amount required to settle the obligation or if a financial liability, in accordance with AASB 139. Any difference between the asset and the liability recognised would result in the recognition of income from the non-exchange transaction.

The ED considers stipulations which may arise in a non-exchange transaction which can be either restrictions or conditions. A restriction is considered to be a limitation or direction for the use of the transferred asset, without the requirement to return the transferred asset. An example of a restriction is that the asset should be utilised over a stated period (such as the next financial year). In contrast, conditions specify the way the transferred asset should be consumed, with a requirement that the asset is returned if the specifications are not met. An example of a condition is one which specifies that the entity is to use the funds to provide goods to homeless people, or otherwise return the funding to the grantor. The ED indicates that conditions will give rise to a present obligation but restrictions will not. This means that if there is no requirement to return the transferred asset, revenue must be recognised immediately and not deferred. It will not always be clear as to whether a stipulation is a restriction or a condition. Entities will need to consider the substance of the arrangement and not merely its legal form when making such a determination.

The proposed standard permits entities to recognise services in-kind, although this is a not mandatory requirement. Finally, it should be noted that the ED provides requirements for the accounting by recipients only and does not consider the accounting for the grantor.

Impact of proposed standard in Australia

The proposed standard is likely to delay the recognition of income by NFPEs for non-exchange transactions compared to the current requirements under AASB 1004 Contributions, especially where conditions are attached to the asset. AASB 1004 currently requires not-for-profit entities to recognise non-reciprocal contributions as revenues when the entity gains control over the asset, with no consideration given to any conditions attaching to the asset. Control over the asset is usually deemed to occur upon receipt requiring revenue recognition at this point. Under AASB 1004, a present obligation and hence a liability would only arise if the entity fails to meet the conditions attached to the transferred asset and is required to return the contribution. On the other hand the ED proposes that where contributions are received with conditions attached to them, at the date of receipt, an asset and a liability should be recognised with revenue recognised only as the obligations are satisfied.

The deadline for comments on the ED is 30 November 2009. We encourage NFPEs/PBEs to consider the proposals under the ED and provide comments to the AASB/FRSB.

**For more information or to discuss further, please contact Georgina Dellaportas
Tel: +61 3 9288 8621**

**For a more detailed summary on non-exchange transactions, please go to:
[http://www.ey.com/Publication/vwLUAssets/Proposed_standard_on_income_from_non-exchange_transactions/\\$FILE/Hot%20topic_non%20exchange%20transactions.pdf](http://www.ey.com/Publication/vwLUAssets/Proposed_standard_on_income_from_non-exchange_transactions/$FILE/Hot%20topic_non%20exchange%20transactions.pdf)**

Ernst & Young's Oceania Government and Public Sector team



Jim Birch, AM
Health & Human Services
+61 8 8417 1763
jim.birch@au.ey.com



Bill Banks
Infrastructure
+61 2 9248 4522
bill.banks@au.ey.com



Grant Dreghorn
Defence
+61 2 6246 1566
grant.dreghorn@au.ey.com



Greg Field
Federal Government
+61 2 6246 1540
greg.field@au.ey.com



Janine Kirk, AM
Victorian Government
+61 3 8650 7450
janine.kirk@au.ey.com



Geoff Harben
Western Australian Government
+61 8 9429 2314
geoff.harben@au.ey.com



Rosina Hislop
South Australia Government
+61 8 8417 2033
rosina.hislop@au.ey.com



Paul Laxon
Queensland Government
+61 7 3243 3735
paul.laxon@au.ey.com



Alan Judge
New Zealand Government
Tel: +64 4 495 7393
alan.judge@nz.ey.com



Uschi Schreiber
Oceania Government
NSW Government
+61 2 8295 6706
uschi.schreiber@au.ey.com



Tim Coyne
Financial Services
+61 3 9288 8056
tim.coyne@au.ey.com

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Around the world, governments and not-for-profit organizations are continually seeking innovative answers to complex challenges. They long to provide better services at lower costs and to ensure sustainable economic development, a safe environment, more transparency and increased accountability. The public sector, not unlike the private, can learn much through the sharing of insight and best practices.

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If you, or your team members would like to receive further editions, please contact Rachel Molloy at rachel.molloy@au.ey.com

Australia

Adelaide

Ernst & Young Building
121 King William Street
Adelaide SA 5000
Tel: +61 8 8417 1600
Fax: +61 8 8417 1775

Brisbane

1 Eagle Street
Brisbane QLD 4000
Tel: +61 7 3011 3333
Fax: +61 7 3011 3100

Canberra

Ernst & Young House
51 Allara Street
Canberra ACT 2600
Tel: +61 2 6267 3888
Fax: +61 2 6246 1500

Gold Coast

12-14 Marine Parade
Southport QLD 4215
Tel: +61 7 5571 3000
Fax: +61 7 5571 3033

Melbourne

Ernst & Young Building
8 Exhibition Street
Melbourne VIC 3000
Tel: +61 3 9288 8000
Fax: +61 3 8650 7777

Perth

Ernst & Young Building
11 Mounts Bay Road
Perth WA 6000
Tel: +61 8 9429 2222
Fax: +61 8 9429 2436

Sydney

Ernst & Young Centre
680 George Street
Sydney NSW 2000
Tel: +61 2 9248 5555
Fax: +61 2 9248 5959

New Zealand

Auckland

41 Shortland Street
Auckland
Tel: +64 9 377 4790
Fax: +64 9 309 8137

Christchurch

34-36 Cranmer Square
Christchurch
Tel: +64 3 379 1870
Fax: +64 3 379 8288

Wellington

100 Willis Street
Wellington
Tel: +64 4 499 4888
Fax: +64 4 495 7400

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