

# Public sector insights

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Dear reader

Welcome to this edition of *Public sector insights*. Since the last edition, governments around the world continue their efforts in restoring growth and stabilising the economy. However, we have seen a shift from emergency remedies to rebuilding for the future.

Growing budget deficits and continued structural pressures such as rising citizen expectations and ageing populations are demanding more systemic changes. Governments are now under a great deal of pressure to achieve more with less. New delivery mechanisms and greater customer choice will help in this endeavour, while improving resource allocation will encourage a focus on the top priorities.

Our headline article is by Andrew Podger, President of Institute of Public Administration Australia (IPAA). Following the recent IPAA national roundtable held in Sydney, hosted by Ernst & Young, Andrew explores the nature of the global financial crisis (GFC) itself before reviewing the implications for global governance, management of risk and complexity and the impacts on government policy and administration.

I also commend to you our article on citizen engagement via online technology titled *The citizen evolution – The future of public service delivery*.

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

Best regards

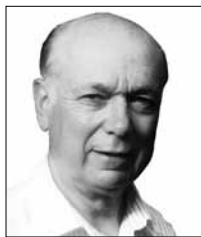
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# What the GFC might mean for government

Andrew Podger, National President - Institute of Public Administration Australia



**Andrew Podger**

In July 2009 Ernst & Young and the Institute of Public Administration Australia hosted a national roundtable to discuss the implications of the Global Financial Crisis (GFC) for the longer-term role of government. The roundtable was attended by 30 Australian senior professionals in public administration, politics and economics.

The roundtable explored issues focusing first on the nature of the GFC problem itself before reviewing the implications for global governance, management of risk and complexity and the impact on government policy and administration.

Australia's Ambassador to the United States, former Opposition Leader and Defence Minister, Kim Beazley, began proceedings with an overview of the political context both nationally and internationally. He questioned Prime Minister Rudd's assessment of the fundamental role of neo-liberal ideology, accepting its relevance in the US but not in Australia. This argument was raised continuously in the roundtable discussion. Beazley also highlighted the international agenda and expressed concern about the capacity to manage the exit strategy after the financial stimulus, particularly in the US and Europe.

## **The source of the problem**

The economists identified a range of sources of the GFC, including the global savings imbalance, inadequate regulation of the financial market, lack of transparency and ill-disciplined fiscal and monetary policies including political opportunism in the promotion of home ownership. The balance between the various sources is still not clear, but they are all primarily external to Australia. The US is a particular culprit, though apportioning blame for the global imbalance between an excessively liberal US and an excessively statist China is difficult.

There was agreement about the importance of transparency, the rule of law and the role for regulation, but some of the economists were far less confident of the macro-economic response by governments than others.

Some of the non-economists were also uncomfortable about the sanguine view of Australia's stance prior to the crisis, noting our light-touch approach to regulation until very recently, and the inappropriate response to the Asian financial crisis initially. Ideology had contributed to these, they suggested, and we were fortunate to have experienced some domestic company collapses which had forced government to take a firmer stance.

## **Global governance**

The global response to the GFC has opened up an opportunity to review global governance issues. Already, more nations have been brought into play in the global dialogue. The developing world also has a strong case to be heard, though it also will need to appreciate the related obligations to act responsibly.

At long last, a serious move away from the post-World War II power framework seems to be underway, with a growing role for the G20, pressure to review governance of the International Monetary Fund (IMF) and the World Bank, and the possible development of regional frameworks as part of the G20 structure. There was caution however about any suggestion of some form of international government rather than international governance, and the continuing central role of national governments was emphasised.

While some improvements in the international dialogue may take place, it was not entirely clear whether the big countries in transition, such as China and India, will see the lessons from the GFC as

the need for further opening of their economies and societies or the very reverse given the contribution of unregulated markets and weak governments in the west. Some roundtable participants were also uncertain about the economists' assumption that globalisation is entirely beneficial, highlighting the importance of the problems of inequity and lack of sustainability that globalisation can exacerbate and the need to engage more meaningfully with the third world.

## **Managing risk and complexity**

One of the lessons emerging from the crisis is the need for government to play a stronger role in managing risk and complexity. Possible principles were explored such as linking more closely asset and liquidity requirements to real risks and the capacity of businesses and financial institutions to manage them. It was certainly clear that the capacity of monetary policy to address shocks such as the GFC was sharply constrained if there are weaknesses in the regulation of financial markets.

The downsides to competition in financial markets were also recognised, and the need for 'second best' processes which balance competition and market stability. Those who benefit from such processes, whether through government guarantees or other policies which protect them from competition, need to accept a quid pro quo responsibility to the community. Transparency is not sufficient: some community expectations about acceptable behaviour and financial rewards do need to be met.

## **Government policy and administration**

Several participants expressed concern about presenting the GFC as a crisis of ideas, particularly for Australia. To do so ran the risk of governments drawing the wrong lessons, and not building on the

strengths of the economic reforms of the last 25 years. There may be a case for a new review of the financial system and its regulation, given the changed circumstances since the Wallis Inquiry, but a wider revisiting of our market reforms would be unwise.

Of more immediate concern is the development of an exit strategy following the stimulus measures, and clarification of the ongoing role of government. Some were concerned about the lack of a longer-term micro-economic reform agenda and insufficient understanding of the scale of the problem of turning around government debt (in Australia and, more particularly, in the US and Europe). Others were equally concerned about the long-term social consequences of rising unemployment over the next year or more, and the capacity to re-engage those displaced and alienated by the recession.

A political challenge will be to engage the community about the challenges and choices involved, in order to increase the capacity of government to move forward confidently.

Another impact of the GFC may be to add more pressure on our federal arrangements, as the international agenda inevitably requires a greater role for national governments whether through stimulation packages or business regulation reform, further reducing the autonomous powers of sub-national governments.

### **Conclusions**

While no formal conclusions were reached, there were several recurring themes.

Firstly, we need to be careful and avoid complacency. The very surprise of the GFC should make people cautious about drawing firm conclusions too quickly. The current signs of recovery will not halt a

significant rise in unemployment and its social consequences: the public view in a year's time may not reflect the current optimism. The exit strategy will be long and hard. There is a danger of governments drawing the wrong conclusions from the crisis adding to the exit strategy problem.

Secondly, there is an unease (though not shared by all participants) about interpreting the GFC as a clash of ideas. This runs the risk of derailing sensible policy discussions, when the appropriate global response is likely to be both more open operation of global markets and more effective regulation by national governments.

Thirdly, it is unlikely that the GFC will or should lead to a substantial shift to the left. It certainly has reinforced the important role of governments in macro-economic management and regulating for market failure. There has also been the long-overdue recognition that debt-financing of public infrastructure is not necessarily bad. But the basic disciplines of government financial management remain, including rates of return, capacity to repay debt, ensuring private benefits are privately financed, using competitive processes to ensure best value for money etc. Governments are also on notice that their currently higher standing will not last if implementation of stimulus measures and ongoing programs is not successful or if policy settings (and the capacity for policy advice) prove inadequate.

Finally, it is important not to allow the debate to be taken over by the economists, particularly after so many failed to predict the GFC or anything like it. Other experts need to be listened to, and the public engaged in the policy debates.

The global response to the GFC has opened up an opportunity to review global governance issues. Already, more nations have been brought into play in the global dialogue. The developing world also has a strong case to be heard, though it also will need to appreciate the related obligations to act responsibly.

'Once bitten twice shy'  
Will there be a second bite to the GFC? What are the implications to government if there is?

# Mind the gap - Financing the gap in transport infrastructure

Australia understands the benefits of infrastructure development and the specific projects to deliver. Infrastructure Australia has articulated a significant task to build infrastructure for the future. There is an intergenerational issue to be confronted in relation to the ability to pay and build today for tomorrow.

The global financial crisis reduced the \$20 billion planned for the Building Australia Fund leaving approximately \$8.5 billion for rail, road and port infrastructure projects. As a result, a number of key projects failed to achieve funding, with only three projects receiving 66% of the total allocation. The remaining projects present a real gap in transport infrastructure funding. States are unlikely to be able to fill the gap, given the pressure on their balance sheets and limited revenue sources.

## **Stopping all stations - a sustainable funding model**

Beyond the available funding pool, attention needs to be steered towards the root of the problem. The key question is why the finance can not be found when the economic needs and benefits are so clear?

The simple answer is that we tend to fund transport infrastructure indirectly, for example, through state balance sheets, rather than directly through appropriately pricing the use of transport infrastructure. User-pays pricing systems can deliver the revenue stream against which capital can be borrowed or invested to fund construction and operations. Appropriate pricing also supports the most economically efficient use of transport infrastructure. While the fuel excise is an existing example of user charging, its revenues may be appropriated to other priorities.

The right pricing model can create efficient and appropriate infrastructure. This will enable capital to be attracted through either public or private models. It is the appropriate pricing of transport use that supports project funding and not the delivery model. For example, toll roads have been successfully delivered by both public and private sectors. These projects' revenue streams supported their capital raising. The decision to deliver through a public or private vehicle is a secondary issue which relates to the specific needs of the project, efficient allocation of risk, certainty of service outcomes and value for money.

An opportunity exists, for example, to overhaul the funding of roads through charging some commercial vehicles based on their use (including time of day) and impact on road maintenance. This could release capacity during the peaks which delays the need for capacity expansion projects. It also provides a sustainable funding source for our key economic roads and a level playing field for rail.

## **Running express to long-term solutions**

Investors are looking for sustainable, safe and long-term investments. Large infrastructure projects will logically win attention if policy makers can offer a pricing model that translates into an effective revenue stream for all players.

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# Program evaluation – From policy to implementation to improvement

“Evaluation is an integral part of the policy cycle for government reform. An objective, thorough, rigorous and timely evaluation has the potential to inform policy and achieve real change in the community.”

*Uschi Schreiber, Managing Partner – Government & Public sector, Ernst & Young*

Governments are tasked with the role of designing, planning, implementing, and administering policies and programs that benefit the community by addressing some of society’s most difficult problems.

Program evaluation is an essential tool for a government committed to societal change. It has the potential to improve informed policy and program design, implementation and delivery performance.

While it can be expensive and time consuming, program evaluation is an important tool for determining whether the desired goals have been achieved. It can also assess if future additional funds are warranted to provide potential reform improvements to the program.

In theory, program evaluation is an integral part of the policy cycle and a key decision-making tool (see figure one on page six). It investigates if a program is successful and enables stakeholders to learn from the experience. Its recommendations are pragmatic and action-focused. They feed back into the policy cycle so they can be applied to further develop that and alternative programs. Learning is shared across departments and jurisdictions so they can emulate the program’s successes and avoid its mistakes.

The most commonly encountered systemic barriers to good evaluation include:

- ▶ Evaluation as an afterthought
- ▶ Quality data - Poorly planned programs often overlook the importance of collecting information over time on program costs and outcomes.
- ▶ Structural support - focus on overall goals of the program.
- ▶ Engagement of all stakeholders - Effective delivery requires sharp alignment between government, business and the community
- ▶ No exit strategy
- ▶ Confusion with other measures
- ▶ Scarce resources
- ▶ Cultural issues
- ▶ Accountability fatigue

From our extensive interaction with the public sector, we have identified four key areas for improving program evaluation these include:

- ▶ Cultural commitment
- ▶ Continuous improvement approach
- ▶ Better data quality
- ▶ Better analytical techniques

“No program is a complete success or failure: most are somewhere in the middle, and can be improved by regular evaluation that supports continuous improvement. Even a program that is anecdotally judged to have failed offers lessons that need to be captured and shared. This is to avoid mistakes in the future, possibly on a larger scale.”

*David Cochrane  
Partner, Ernst & Young*

Repositioning program evaluation is a complex challenge that involves a significant culture change within government. There is however no silver bullet and change is likely to occur incrementally. Ernst & Young's Government & Public Sector practice has formulated several recommendations for consideration. Figure two illustrates the recommendations and shows that together they offer a holistic solution to the program evaluation challenge.

**Conclusion**

While program evaluation in theory is recognised as an important component of policy and program development, in reality it is still often seen as an afterthought due to tight timeframes and competing demands. As a result, the quality of the reports is variable at best. At worst, the outcome of a poorly planned and executed evaluation can be the continuation of poor government policy.

The cultural transformation involved in repositioning evaluation means it will be some time before every program evaluation is as independent, action oriented and timely as it should be.

However, with the right data scoped in the design stage and the discipline to use it consistently, coupled with a continuous improvement mindset, program evaluation can be successful in determining program outcomes and actions.

Evaluation needs to be part of an end-to-end culture. This is a way for agencies to demonstrate evidence based thinking. With the right attitude and application, evaluation can be a valuable tool for ensuring decision-makers at all levels have the evidence and information they need to make informed and appropriate choices about the allocation of public resources.

Ernst & Young's Government matters - *From policy to implementation to improvement* explores the challenges in continuously improving the approach to evaluation. For a copy of the full report please contact Natalie Frazer Tel: +61 3 9288 8915

Figure one - Policy development cycle

Australian Policy Handbook, C.Althaus, P. Bridgman, G. Davis, 4th ed., pub. Allen & Unwin 2007

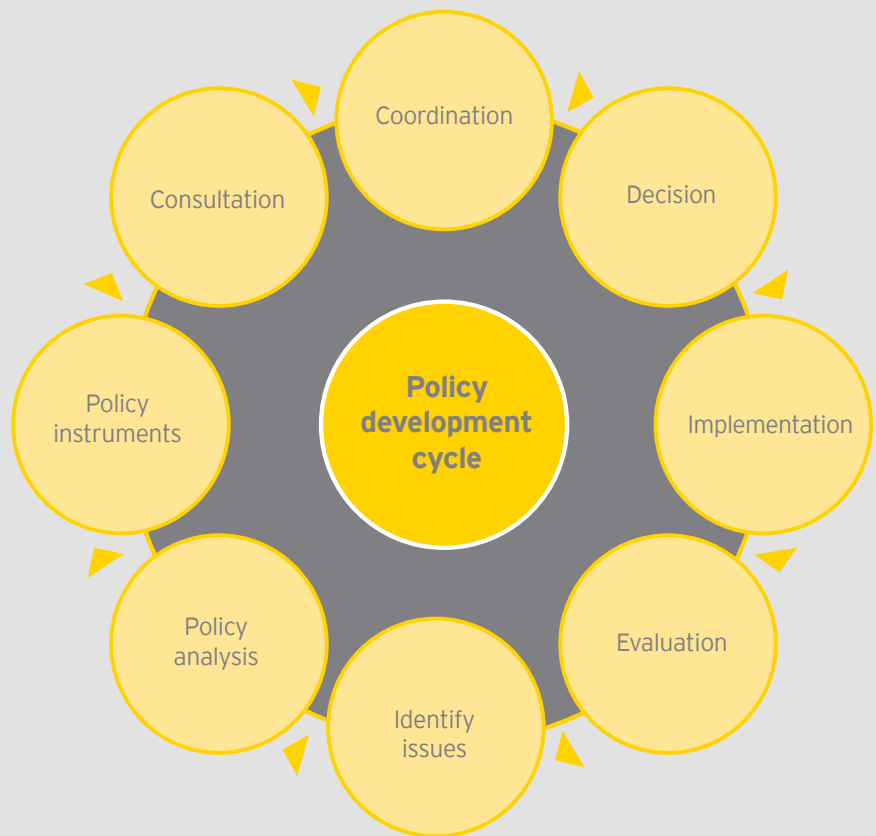


Figure two - Program evaluation challenge



# Fair value – Public sector asset valuations

The turbulent market conditions, apparent by the loss of liquidity and the number of forced asset sales, have made it increasingly difficult in determining the fair value of assets.

Recent turmoil in financial markets as a result of the global financial crisis has increased the focus on fair value reporting - an accounting standard that is not a new issue for government entities.

Traditionally, Treasury guidelines issued by both Federal and State governments specified that property, plant and equipment assets were to be measured at fair value or a cost basis. However the introduction of AASB 1049, Financial Reporting of General Government Sectors by Governments, has eliminated that choice - meaning that government departments, agencies and State government business enterprises must now only use fair value.

The turbulent market conditions, apparent by the loss of liquidity and the number of forced asset sales, have made it increasingly difficult in determining the fair value of assets. Adding to the weight of the problem, the AASB 1049 does not provide detailed guidance around how fair value reporting should be conducted.

Fair value reporting has received much criticism; however the public sector must adhere to the new guidelines. This change may take a while to get used to and the following issues should be considered when amending your reporting framework:

- ▶ Frequency of reporting
- ▶ Assets will require regular valuations to ensure they remain within a reasonable fair value range
- ▶ Different methods for valuation
- ▶ In regards to determining fair value, different valuation approaches will be appropriate for different asset classes; One size no longer fits all

- ▶ Increased cost and time
- ▶ The new guidelines will require rigorous valuation and detailed documentation. You may consider obtaining professional advice, or at the very least increasing the resources and time allocated to reporting

The primary professional body for Australian property, plant and equipment valuers is the Australian Property Institute (API). Valuers are required to prepare valuation reports in accordance with the API's professional practice guidelines which is broadly consistent with the standards of the International Valuation Standards Council (IVSC).

There are three main approaches used to value property, plant and equipment which include:

- ▶ Sales comparison approach
- ▶ Income approach
- ▶ Cost approach

The sales comparison approach is used to value assets with an established and liquid market such as residential property and motor vehicles. Comparable sales may also provide useful information for use in the income approach.

The income approach is often used in the valuation of industrial and commercial properties, typically via a capitalisation of earnings, or for major infrastructure such as airports, shopping centres, and toll roads via a discounted cash-flow approach. The decision on the appropriate approach depends on the information available and the judgement of the valuer.

It's important to embrace fair value reporting from the beginning. Make sure you are across all key considerations and methodologies when developing your new framework. Fair value reporting provides you with the foundation to obtain consistent comparison of key metrics across your portfolio.

The cost approach is used for the valuation of specialised assets, such as plant and equipment, where comparable sales are not available and detailed cash-flows can not be attributed to the underlying assets. The cost approach is also commonly known as the optimised depreciated replacement cost (ODRC) or (DRC).

The first step in the DRC is to estimate the current replacement cost of a modern equivalent asset. This is often less than the cost to replicate the subject asset due to developments in design and materials of construction. The modern equivalent asset may also be subject to optimisation to adjust for over design; related to excess capacity above and beyond what is reasonably required in the medium term.

The replacement cost is then depreciated based on three forms of obsolescence; physical, functional, and economic.

- ▶ Physical deterioration is the loss in value due to wear and tear and generally measured as a function of the total estimated asset life.
- ▶ Functional obsolescence is the loss in value caused by inefficiencies of the asset itself when compared to a more efficient or less costly replacement asset. When compared to new technologies the subject asset can exhibit excess operating costs, excess construction, over-capacity, inadequacy, or lack of utility.
- ▶ Economic obsolescence is the loss in value caused by factors external to the property such as increased input costs (raw materials, labour, or utilities), reduced demand, increased competition, environmental factors and legislation.

Economic obsolescence is often measured by reference to the value in use; to the entity where the assets belong and the other underlying assets and liabilities. Where the value in use is not a reliable measure as the entity is a not-for-profit then economic obsolescence becomes a function of the service potential rather than the profitability of the entity.

As discussed above the appropriate approach to use when valuing property, plant and equipment is a function of the asset class and market for that asset class. Liquid assets such as residential property may be best measured using the sales comparison approach whereas the cost approach may be more appropriate for a gas distribution network.

It's important to embrace fair value reporting from the beginning. Make sure you are across all key considerations and methodologies when developing your new framework. Fair value reporting provides you with the foundation to obtain consistent comparison of key metrics across your portfolio. It may also provide you with other benefits such as increased visibility and clarity over the value of your assets, and you could possibly use the underlying data for other purposes such as insurance, estimating realisable values and in determining regulatory values for pricing purposes.

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# The citizen evolution – The future of public service delivery

Today's citizens are becoming increasingly familiar with the use of on-line channels to support both social and commercial interactions. Highly personalised, anytime, anywhere access to information and information services is now the norm. The increased expectations of these new "e-citizens" has important implications for the provision of government services not only in the ability to carry out business with government more easily and quickly but also in an increasing demand for transparent access to government data and a richer model of citizen engagement.

The concept of "Web 2.0" is now well established and has been used to describe the evolution of internet usage to a model that is centred around the themes of collaboration, participation and many to many interactions rather than the more "static" information exchange characterising earlier web usage. The Web 2.0 concept has also been extended to the public service arena with the notion that "Government 2.0" describes application of Web 2.0 concepts and technologies to the business of government, in particular more direct engagement with citizens.

Many governments around the world have experimented with Government 2.0 approaches (indeed the Australian Federal Government has recently established a government 2.0 Taskforce). It could be argued however that advances in Government 2.0 have lagged significantly behind adoption of Web 2.0 in other spheres. The resultant gap in citizen expectations is a potential issue for governments but also represents opportunity for significantly more value to be delivered to a more engaged public by government.

Government budgets are constantly under pressure but at the same time the growing expectation gap in service delivery represents

a demand for improved service delivery. Doing more with less would therefore seem to be the challenge. Judicious use of Government 2.0 concepts allow the possibility of doing just that by increasing the value delivered to the public while at the same time improving the effectiveness and efficiency of government services.

Ernst & Young has developed a Government 2.0 value map that highlights key areas where Web 2.0 concepts can successfully bring value for government. (See figure three, on page ten).

Many initiatives have started to emerge globally demonstrating the value of Government 2.0 approaches. Effective government 2.0 initiatives include:

- ▶ In the UK, citizens can report, view and discuss local issues in an interactive online map, this includes feedback on broken road signs, street light and graffiti. This initiative demonstrates the desire for engagement from citizens and develops a real partnership between citizens and the local councils.
- ▶ In the USA and now in Australia, Federal governments have recently opened websites to make public data accessible for all citizens ([data.gov](http://data.gov) and [data.australia.gov.au](http://data.australia.gov.au)). The objective is to improve access to public data and to tap into the creativity of the community to provide information in innovative ways.
- ▶ In the UK, PatientOpinion aims to improve the National Health Service. Patients can transparently provide feedback on their experience with healthcare facilities and can consult reviews from other patients. This initiative is mainly funded by hospitals willing to be transparent in mitigating risks and improving services.

Not all Government 2.0 initiatives are implemented directly by or with the government. E-Citizens are willing to get engaged and participate in the improvement of public services indirectly. While government can not control every citizen-driven initiative, a framework with policies and best practice should be implemented to increase the quality of services delivered by these active e-citizens and reduce related risks. The following examples highlight both the value of such initiatives as well as potential risks for government:

- ▶ RateMyTeacher.com is a privately owned web site that provides a framework for all students in Australia, Canada, United Kingdom, New Zealand, Ireland and United States to give open feedback and rating on their teacher. Teachers are named and their performance as seen by their customers (students) is shared on the internet increasing reputation risks with little control from government. Government can mitigate that risk by adopting similar transparent initiatives that could be owned and managed by government agencies.
- ▶ In Australia, there are various examples of e-citizens using publicly available data to develop free or low cost mobile phone applications providing services to the broader community: TripView is a public transport application that assists commuters in preparing their trip by leveraging data provided by RailCorp. NSW Food Watch is another application that uses data openly shared by the NSW Food Authority and leverages the GPS capability of a new generation mobile phone to indicate on a map the restaurants and food facilities nearby that were recently fined. Both of these examples could constitute a reputational risk if not governed by minimal rules of engagement.

Government agencies need to consider the benefits in collaborating with e-citizens and industry in order to provide improved services to the public and mitigate associated risks.

While the promise is significant there are many challenges that need to be addressed including:

- ▶ Change management
- ▶ Getting the right information technology infrastructure that ensures that citizens can utilise the new system efficiently in their daily use
- ▶ Records and information management with a focus on data quality and accuracy
- ▶ Security and privacy

Key considerations for government agencies include:

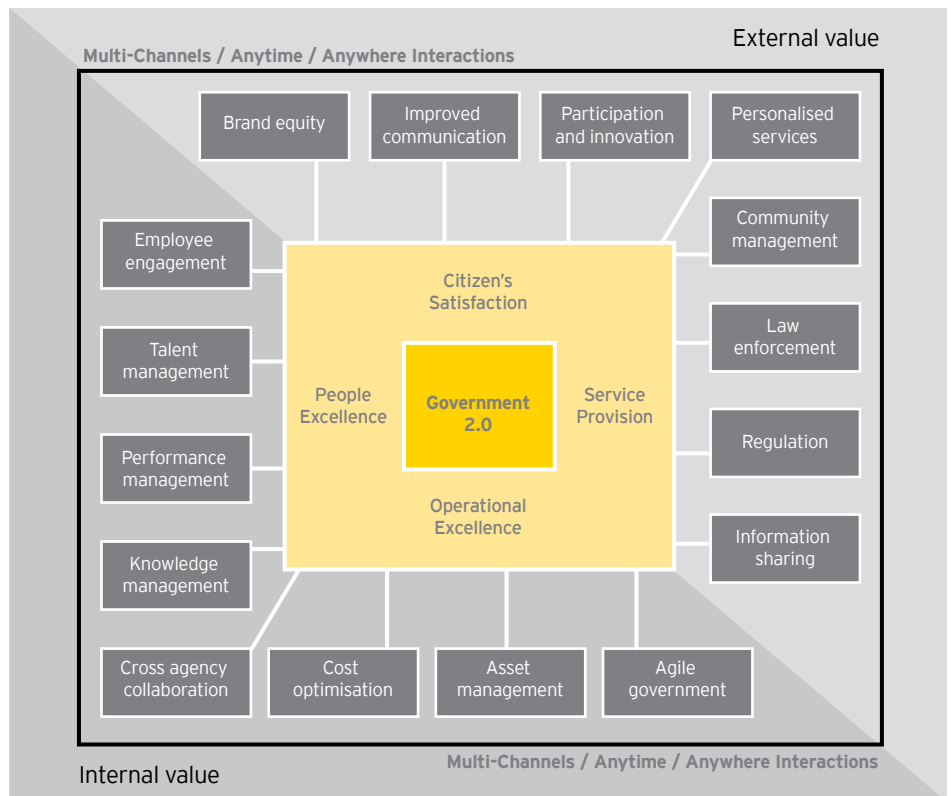
- ▶ Who is your target community of e-citizens?
- ▶ How can you engage effectively with this community online?
- ▶ How can you sustainably increase participation and public engagement?
- ▶ What value could your community of users add to your data?
- ▶ Does it make sense to partner with industry experts?
- ▶ Where are the capability gaps in your agency?
- ▶ What are the measures for success?

Emerging online technologies provide huge opportunities to innovate and engage differently with citizens and modernise public services with the participation of the broader community. Not only is this improved engagement likely to increase the overall satisfaction of citizens but will reduce costs for government allowing them to do more with less.

With the rate at which social and technological trends are changing the biggest risk for government is the risk of not acting.

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Figure three -Ernst & Young's Government 2.0 value map



**Golden rules:**

1. All citizens are different so don't treat them the same
2. Articulate the value to citizens in terms that they recognise; cost, value, convenience, quality and service
3. Offer choice of channel, and where possible allow citizens to self serve
4. Listen to what the citizens are saying, give them a voice into your department
5. Understand what you are trying to improve for your citizens and measure the impact/progress

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## About Ernst & Young's Government and Public Sector Practice

Around the world, governments and not-for-profit organisations 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. Drawing on many years of experience, we work with you to help you strengthen and secure your organisation, deliver value for money and obtain lasting improvement.

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It's how Ernst & Young makes a difference.

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

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