

THE AUDIT OFFICE
NEW SOUTH WALES



THE AUDIT OFFICE
OF NEW SOUTH WALES

New South Wales
Auditor-General's Report

Financial Audit

Volume One 2011

The role of the Auditor-General

The roles and responsibilities of the Auditor-General, and hence the Audit Office, are set out in the *Public Finance and Audit Act 1983*.

Our major responsibility is to conduct financial or 'attest' audits of State public sector agencies' financial statements. We also audit the Total State Sector Accounts, a consolidation of all agencies' accounts.

Financial audits are designed to add credibility to financial statements, enhancing their value to end-users. Also, the existence of such audits provides a constant stimulus to agencies to ensure sound financial management.

Following a financial audit the Office issues a variety of reports to agencies and reports periodically to parliament. In combination these reports give opinions on the truth and fairness of financial statements, and comment on agency compliance with certain laws, regulations and Government directives. They may comment on financial prudence, probity and waste, and recommend operational improvements.

We also conduct performance audits. These examine whether an agency is carrying out its activities effectively and doing so economically and efficiently and in compliance with relevant laws. Audits may cover all or parts of an agency's operations, or consider particular issues across a number of agencies.

Performance audits are reported separately, with all other audits included in one of the regular volumes of the Auditor-General's Reports to Parliament - Financial Audits

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The Legislative Council
Parliament House
Sydney NSW 2000

Pursuant to the *Public Finance and Audit Act 1983*,
I present Volume One of my 2011 Report.

A handwritten signature in black ink that reads 'Peter Achterstraat'.

Peter Achterstraat
Auditor-General
February 2011

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Waste Recycling and Processing Corporation (WSN Environmental Solutions)

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Section One



Compliance Review Report - Procurement Reform of e-Procurement and e-Tendering

6

NSW Auditor-General's Report
Volume One 2011

COMPLIANCE REVIEW REPORT
- PROCUREMENT REFORM OF
E-PROCUREMENT AND E-
TENDERING

I found widespread non-compliance with e-procurement requirements and to a lesser extent with e-tendering requirements. Very few agencies complied with both requirements.

Electronic procurement and tendering offers benefits to both the individual agencies using the services and the State as a whole. These include:

- leveraging the State's purchasing power to obtain better value for money
- improving transparency of agency negotiations with the private sector
- ensuring appropriate and cost efficient procurement decisions are made
- ensuring access to the expertise and specialist skills at central agencies, NSW Procurement (NSWP) and the Department of Services, Technology and Administration (DSTA) to help agencies negotiate complex transactions in increasingly sophisticated markets
- avoiding unnecessary costs duplicating specialist skills at multiple agencies
- allowing NSWP to track agencies' purchasing patterns so new contracts for products in demand can be negotiated with suppliers of choice
- ensuring DSTA can verify the completeness of supply fees payable by suppliers on State Contract Control Board (SCCB) contracts
- reducing the risk of procurement fraud, corruption and collusion (ICAC's July 2010 report found collusion in 62 per cent of its procurement related investigations)
- decreasing transaction costs and improving transaction trails (electronic transactions with automatically generated audit trails and programmed controls offer cost, accuracy and efficiency savings compared to manual transactions).

Compliance Criteria

I reviewed 19 agencies' compliance with The Premier's Memorandum M2006-11 'NSW Procurement Reforms' during the year ended 30 June 2010. The Memorandum requires agencies to implement and use e-procurement and e-tendering systems for relevant procurements. I will shortly issue review reports to the individual agencies reviewed.

There are inherent limitations in undertaking an engagement of this nature. My work was conducted as a review engagement, not an audit. Consequently my procedures were not designed to detect all instances of non-compliance. My review provides limited assurance and expresses my conclusion about whether the agencies reviewed had complied with the Memorandum.

Overall Conclusion

I found the level of non compliance with the requirements of this Premier's Memorandum concerning, particularly considering the NSW Procurement Reforms were effective since 2006. The implementation strategy for procurement reform was announced as early as 2001.

Background

Each year government agencies (excluding State owned corporations) transact with the private sector to procure goods and services. The value of these transactions was \$23 billion in the financial year ended 30 June 2010 and is expected to exceed \$23.6 billion in 2011. Although electronic procurement offers significant advantages over manual procurement only a small portion is transacted electronically.

Electronic procurement functions are administered by two bodies. The SCCB negotiates and contracts with suppliers of a range of commonly used goods and services. DSTA administers the Smartbuy portal through NSWP. Smartbuy references to contracts negotiated by the SCCB and collects data on agency purchasing patterns. This data is used by the SCCB to negotiate better contracts for the State and can be used by DSTA to verify fees remitted by suppliers under the terms of their contracts, generally calculated as a percentage of the agency spend.

Electronic tendering is administered by DSTA through NSWP which updates the e-tendering website with information supplied by agencies about upcoming, current and closed tenders. NSWP also has a pool of experienced staff to help agencies with tender negotiations.

Electronic procurement and tendering offers potential advantages in effectiveness and efficiency to agencies, but remains underutilised.

Over one third of agencies reviewed did not comply with e-procurement requirements. Almost half did not comply in some respect.

The Premier's Memorandum M2006-11 requires agencies with total expenses exceeding \$400 million per annum (other than State owned corporations) as well as agencies named in Schedule 1 of the *Public Sector Employment and Management Act 2002* (the Act) to use Smartbuy for e-procurement, unless they use an alternative electronic procurement system approved by the Government Chief Information Officer (GCIO).

In addition, these agencies must notify DSTA and use the e-tendering web site for all procurements greater than \$250,000 that are not available through SCCB contracts.

There are exemptions to the requirements for accredited agencies, purchases from prequalified suppliers and local area suppliers.

Key Issues

I recommend the governing bodies of agencies and management review, not only the processes their agencies have in place to comply with procurement reforms and requirements, but also more broadly how agencies identify and comply with laws, regulations, Treasury policy pronouncements, Premier's memoranda and other obligations.

I recommend the Government, through the responsible agencies, review the scope of the Premier's Memorandum and the *Public Sector Employment and Management Act 2002* and redefine the terms and expenditure limits with the aim of increasing the number of agencies and the proportion of the State's procurement subject to the requirements.

Improvements would include:

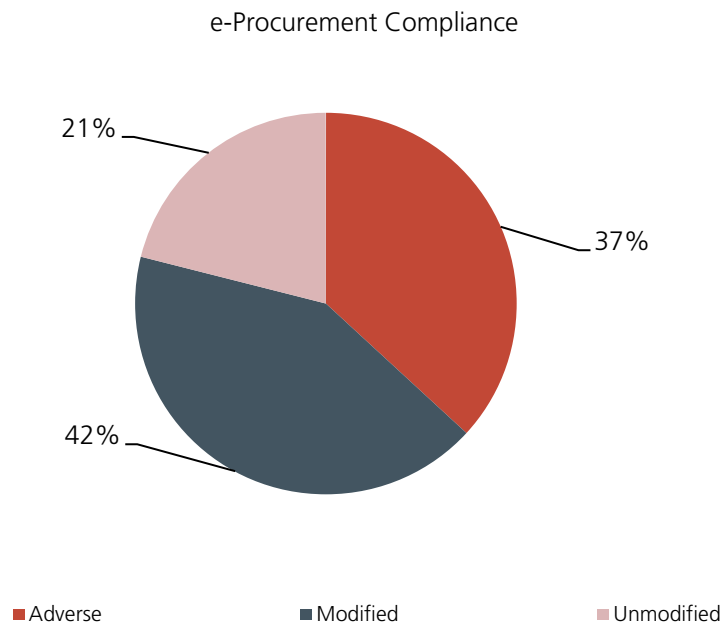
- defining terms to remove any uncertainty as to whether an agency needs to comply and the actions it should undertake to comply
- ensuring the requirements capture all major procurement agencies. Schedule 1 of the Act lists major employers in the NSW public sector, which are not necessarily the State's largest procurers. Indeed many of the entities listed are employment divisions and have no procurement functions of any substance
- capturing smaller agencies not currently subject to requirements. With improved use and accessibility, and lower costs of installing Smartbuy systems and processing transactions, smaller agencies may benefit from being able to access SCCB contracts because:
 - their purchasing power is limited (and potential savings greater)
 - they may have less robust controls over procurement due to the size of their agency
 - they can access skills and expertise not otherwise available to them
- ensuring all data on procurements transacted by shared service organisations is captured. While agencies themselves may be subject to e-procurement requirements, the shared service organisations are not. Shared service organisations access SCCB contracts for purchases and are delegated authority by the SCCB to negotiate new contracts specific to the agencies they serve. However, the systems do not interface with NSWPS therefore information about their procurements is not available to the SCCB.

Overall Findings - e-Procurement

Overall there was very poor compliance with the Premier's Memorandum. Some agencies had not implemented any systems, policies or procedures to ensure compliance, despite the reforms being announced five years earlier. Many other agencies only complied with the requirements occasionally.

The number of Government policy requirements, guidelines and exemptions contributes to poor compliance.

The graph below illustrates the form of review reports I expect to issue to agencies regarding e-procurement.



I recommend agencies improve compliance with e-procurement requirements by ensuring:

- appropriate GCIO approved systems are implemented
- the systems installed access current SCCB contracts
- appropriate policies and procedures are in place and adhered to by staff
- internal audit monitors compliance with requirements
- staff are trained in the use and application of e-procurement and/or Smartbuy systems.

Of the 19 agencies reviewed, only four agencies complied with the requirements of this Premier's Memorandum in all material respects. All other agencies did not comply or did not consistently comply with the requirements and will receive adverse or modified review reports accordingly. At these agencies:

- electronic purchases were made from non-SCCB suppliers because the systems did not access current contracts. Systems at these agencies do not appear to have been regularly updated and refreshed with current contract data
- goods were purchased manually rather than electronically. Agency staff either ignored the requirements entirely (resulting in purchases from non-SCCB suppliers), or used Smartbuy as a 'look up' service to access details of government contracts but completed the transactions manually
- policies and procedures over electronic procurement had not been developed or were ignored or overridden by those responsible for procurement transactions
- manual purchasing was used for procurements under \$30,000 and e-tendering was used for purchases greater than \$30,000. By using e-tendering for services under \$250,000, the agency avoided implementing an e-procurement system as required, engaged non SCCB suppliers and negated economies, as e-tendering has higher transaction costs than e-procurement for the agency, NSW and the supplier.

I recommend central agencies review the requirements covering manual and electronic procurement, so all government initiatives, requirements and exemptions can be easily accessed and understood.

A redesign of the NSW website to explain and link requirements, including a decision tree covering both manual and electronic procurement requirements, would help agencies navigate the complex requirements.

The policies and requirements relating to both manual and electronic procurement are oversighted and/or implemented by more than one central agency. As well as the 2006 NSW Procurement Reforms announced by the Department of Premier and Cabinet (DPC) and administered by DSTA through the SCCB and NSW, there are a range of other requirements and exemptions including:

- General Procurement Requirements (Treasury Policy and Guidelines Paper TPP 09-04) (Treasury)
- Code of Practice for Procurement January 2005 (NSW)
- Simple Procurement Guidelines May 2007 (NSW)
- Procurement Planning Guidelines December 2006 (NSW)
- Procurement of Photocopier Equipment Treasury Circular TC 06/01 (Treasury)
- Implementation Guidelines – Code of Practice and Code of Tendering July 1996 (NSW)
- Information and Communications (ICT) Capital Investment Process November 2006 (Treasury)
- Construction Procurement valued to \$1 Million Guidelines (DSTA)
- General Purchasing Delegations (Treasury/DSTA & SCCB)
- Local Jobs First Plan June 2009 (NSW)
- 2008-2010 Contractor Prequalification and Best Practice Accreditation Scheme for Construction and Related Works (NSW)
- Premier's Circular C2008-34 Prequalification Scheme: Performance and Management Services (DPC)
- Local Jobs First Plan Premier's Circular C2010-09 (DPC) and Treasury Circular TC 10/03 (Treasury) (NSW Department of State and Regional Development).

The SCCB advises its Business Plan 2010 – 2013 provides a blueprint for it to assume overarching responsibility for government procurement. It intends working with Treasury to review NSW Government Procurement Policy and related compliance mechanisms to achieve a clear, simple and comprehensive policy framework.

I recommend that NSW work with agencies and the GCIO to:

- ensure all agencies have systems that are capable of basic service delivery
- ensure agency systems consistently and accurately reference current SCCB contracts
- develop interfaces to agency and shared service organisation systems so NSW can improve the quality and quantity of data captured on agency procurements.

SCCB negotiates contract prices based on projected purchases by agencies, however contracts also require suppliers to remit a fee based on a percentage of the actual purchases. Agency non compliance and a lack of systems integration between central agencies, shared service organisations and agencies means a large portion of vital information is unavailable to DSTA and the SCCB. This weakens the negotiating position of the SCCB and leaves DSTA unable to verify the accuracy of fees calculated on purchase volumes, remitted or payable by suppliers under the terms of SCCB contracts.

The Premier's Memorandum requires agencies to seek GCIO approval if they implement an e-procurement system other than Smartbuy. I noted a variety of systems used by agencies which were not approved by the GCIO.

Failure to use appropriate systems and secure GCIO approval meant e-procurement systems implemented at some agencies do not interface with NSW. Systems such as SAP and Oracle used at a number of agencies and shared service organisations have the theoretical capability of interfacing with NSW to provide this information but so far this has not been explored. Deficiencies in some systems meant they did not consistently access SCCB contracts.

Non compliance and diverse practices have a significant cost to the State. Systems that do not consistently access SCCB contracts or interface with NSW systems undermine the effectiveness of the policy.

There is significant scope to improve the use of Smartbuy by agencies.

The future of electronic procurement means central agencies need to collect and analyse information to anticipate demand and volumes, identify changes in purchasing patterns and have accurate, reliable information available when negotiating contracts with suppliers. Some agencies reported that they pursued manual purchasing because they were able to negotiate a price lower than the SCCB price listed in Smartbuy. This becomes a self perpetuating problem because the supply fee is lost, the manual purchase is not captured in the system and the information is not available when the contract is renegotiated.

Clearly, for the State to leverage its purchasing power effectively, this should not be happening.

I recommend that NSW, the SCCB and DSTA engage with agencies and implement regular programs to increase the use of Smartbuy and the volume of transactions processed by:

- educating agencies and the staff responsible for procurement on the capability, operation and advantages of using Smartbuy
- reviewing practices at agencies subject to requirements
- seeking feedback from agencies about the services they offer
- developing agency specific catalogues
- investigating, responding to and addressing service deficiencies and user concerns on a timely basis
- implementing a continuous improvement plan.

Having a central system such as Smartbuy offers the advantage of completely and accurately capturing information. NSW acknowledges Smartbuy was not popular when initially launched. Problems meant agencies delayed or resisted implementing compliant systems or developed their own systems.

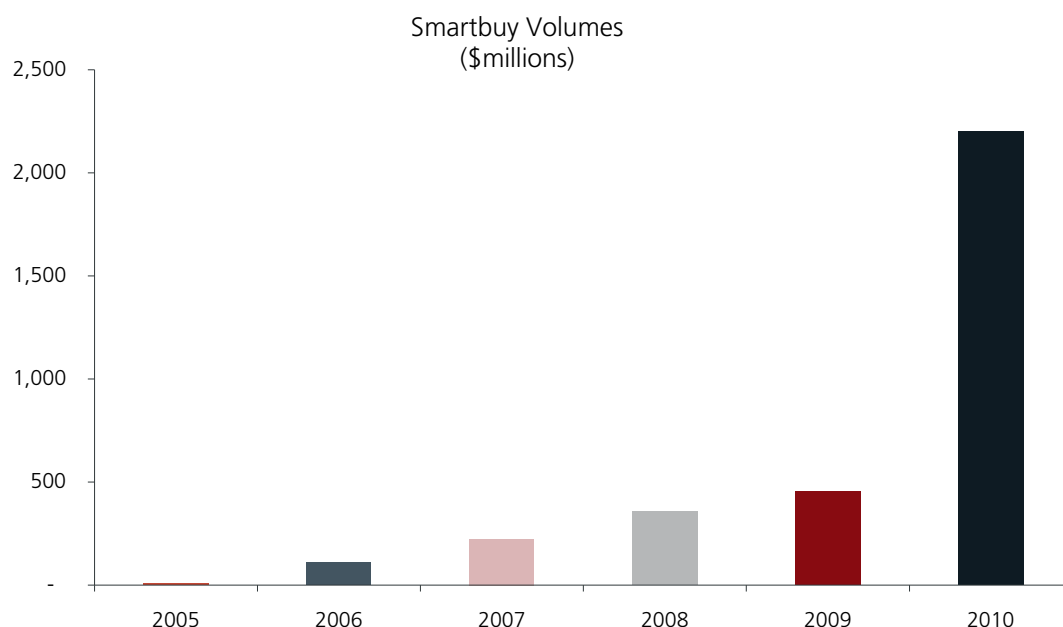
NSW, the SCCB and DSTA have, over the years, addressed many of the issues that hindered its adoption and this has started to have a positive impact on usage. Some agencies and agency staff, however, appear unaware of the improvements and continue to delay implementation, citing issues already addressed in previous upgrades. Smartbuy records 40,000 unique searches each month, but only a small proportion of these eventuate in a completed transaction. There is scope for greater engagement with agencies to ensure better use of the service.

NSW upgraded its web portal in January 2010 to increase on line access, lower transaction costs, improve the transaction trail and reduce the incidence of lost or delayed orders. These improvements in service seem to have greatly increased the volume of transactions being processed through Smartbuy. It appears that where the compliance approach failed, improving service delivery has succeeded.

The future success of the service will lie in ensuring that users do not exit the system to obtain information they need to complete a transaction. Once users exit the system and contact a supplier regarding specifications, generally the transaction is completed manually.

37 per cent of agencies were non-compliant with e-tendering requirements in some respect.

The graph below illustrates the volume of purchases made electronically using Smartbuy since the introduction of the NSW Procurement Reforms. Information about the volume of transactions processed by agencies and shared service organisations using other electronic procurement systems is not available.



Source: NSWSP (unaudited).

A Smartbuy Optimisation project is currently underway to address some, but not all the remaining issues. The project will increase Smartbuy functionality and capability, and incorporate a client training module. There is potential for further improvements to functionality which may expand the range of agencies using the service. These include:

- hosting templates and business cards
- improving receipting functions
- user friendly website features and reduced complexity
- improved product information and links to supplier catalogues
- ensuring current and historical contract information is available and accurate
- improved search engine functionality
- order status enquiry features.

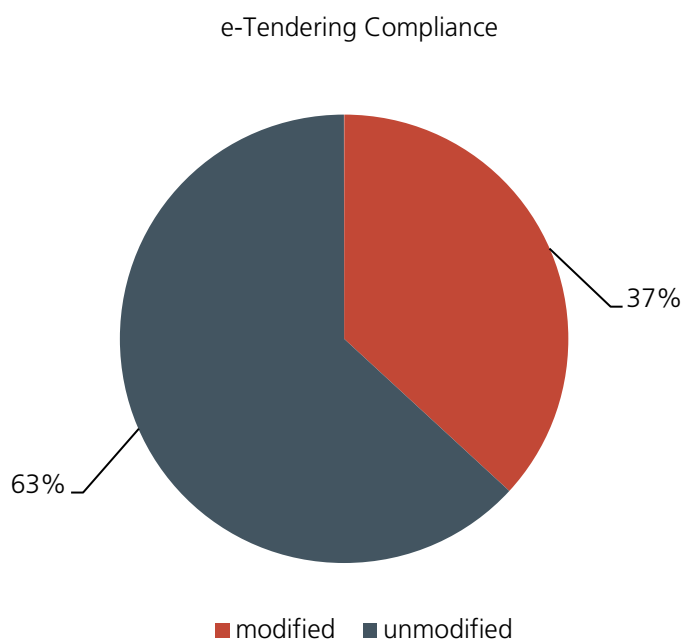
Overall Findings – e-Tendering

Agencies need to improve compliance with e-tendering requirements by ensuring:

- appropriate policies and procedures are in place and adhered to by staff
- agencies reinforce the importance of following due process in all instances
- internal audit monitors compliance
- staff are trained in the use and application of e-tendering systems.

There was a higher degree of compliance with e-tendering requirements than e-procurement because agencies have a higher level of acceptance of the service offered by NSWSP. All agencies were initially given temporary accreditation to pursue their own tendering, but only three agencies applied for more permanent accreditation. Most appear happy to use the service offered.

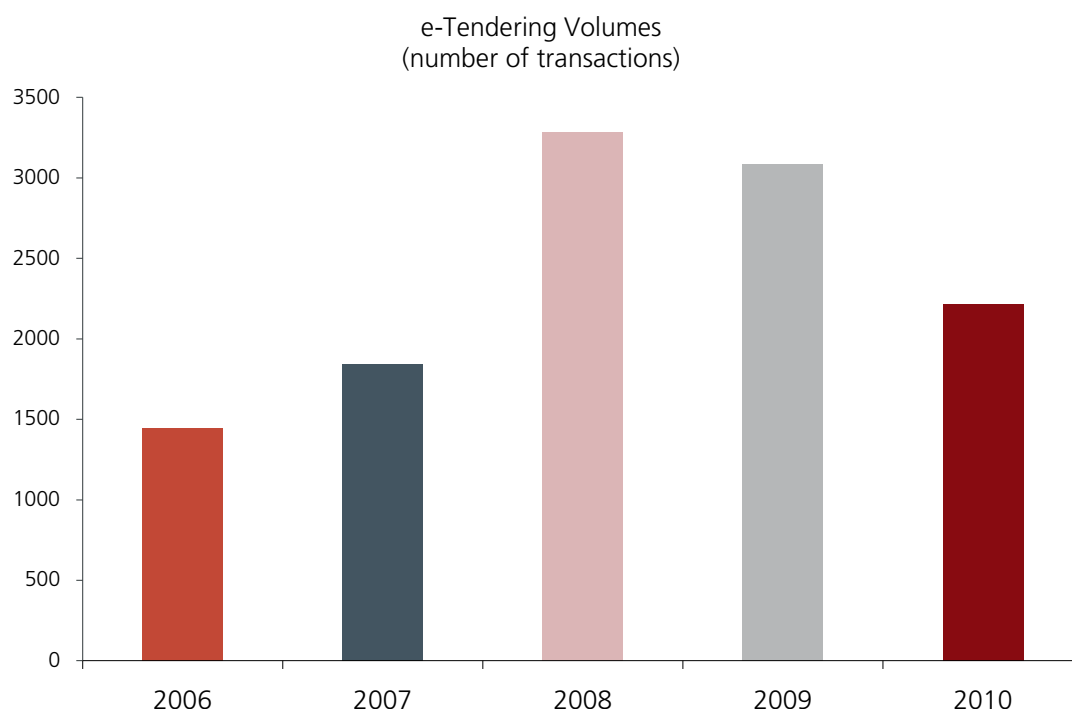
The graph below illustrates the form of review reports I expect to issue to agencies regarding e-tendering.



Of the 19 agencies reviewed, 12 will receive an unmodified review report in relation to e-tendering. At the remaining seven agencies the following instances of non-compliance were identified:

- avoiding due process to deliver a policy initiative by the announced date
- splitting orders where services were supplied by a contractor at multiple locations. Services at each location were treated as separate supplies
- accredited agencies able to conduct their own tenders failed to notify DSTA and publish the projects on the e-tendering website
- using selective tendering rather than e-tendering supposedly because of confidentiality concerns. These concerns did not seem to be valid in most instances.

The graph below illustrates the number of contracts tendered electronically since the introduction of the NSW Procurement Reforms.



Source NSWP (unaudited).

It is unclear why the graph shows a decreasing trend in the number of tenders processed electronically since 2007-08.

The reasons given by agencies for not complying with e-tendering requirements mostly related to achieving delivery dates on projects. Agencies are more likely to pursue their own processes if they perceive the service offered does not add value and/or adds to time delays and red tape.

I again recommend NSWP engage with agencies to obtain feedback on the services offered and implement a program of continuous improvement to ensure the service offered is high quality and adds value to the agencies it seeks to serve.

According to NSWP, the decline in participation since 2008, is likely to be a combination of agencies tendering larger projects rather than many smaller individual projects, the global financial crisis reducing the spend across the board, and the impact of the 2010 Local Jobs First policy.

Reporting of the State's Performance

The State Plan Annual Performance Report

Last year, my Office was engaged by the Minister for the State Plan to verify the performance information relating to the Supporting Business and Jobs Chapter of the Annual Performance Report of the NSW State Plan (the Report). Similar to last year the Government appointed other experts to review the performance information for the remaining chapters of the Report. They were: NSW Chief Scientist; Director of Bureau of Crime Statistics and Research; Chief Executive of the Bureau of Health Information; Chief Executive of the Natural Resources Commission; Director of the Institute for Sustainable futures; Assistant Director for NSW Office of the Australian Bureau of Statistics; and the Director Bureau of Transport Statistics.

My work was limited to agreeing:

- the infrastructure investment data for the years 2005-06 to 2013-14 to the equivalent details in the Treasury Budget Papers for 2010-11
- the private business investment data for the years 1998-99 to 2009-10 to the equivalent details in the Australian Bureau of Statistics, Australian National Accounts: National Income, Expenditure and Product (cat. no. 5206.0)
- the tourist visitor nights and expenditure data for the years 2003-04 to 2009-10 to the equivalent details in the National Visitor Survey and International Visitor Survey by Tourism Research Australia
- the total employed persons data and the unemployment rate data for the months July 2008 to June 2010 to the equivalent details in the Australian Bureau of Statistics, Labour Force Survey (cat. no. 6202.0.0)
- the percentage and time to process data for major project determinations for April 2009 to June 2010 to the equivalent details provided by the Department of Planning
- the proportion of New South Wales business data that innovate for 2006-07 to the equivalent details in the Australian Bureau of Statistics - Innovation in Australia Business (cat. no. 8158.0)
- the dollar value of red tape reduction and reforms data for the period April 2009 to June 2010 to the equivalent details in the Better Regulation Office Report
- the State's AAA credit rating data for 2009-10 with the credit rating agencies of Standard and Poor's and Moody's Investors Services
- the electricity reliability data for the years 2005-06 to 2009-10 to the equivalent details in the Country Energy, EnergyAustralia and Integral Energy Network Performance Reports.

In all instances I found the data agreed to the relevant source documentation.

My procedures did not include:

- evaluating the appropriateness of the performance measures used
- verifying the completeness or reliability of the data
- verifying the accuracy of charts, graphical representations, narrative information, or comparative information other than that highlighted as having been verified by me in the State Plan Annual Report.

I reported the results of my work in a 'Report of Factual Findings', which I issued to the Minister for the State Plan on 24 November 2010.

In previous reports I recommended the Report be finalised, approved by Cabinet and tabled in Parliament by the end of November each year. The 2010 Report was approved by Cabinet, released on 24 November 2010 and tabled in Parliament on 30 November 2010.

I am liaising with the Strategy and Project Delivery Unit of the Department of Premier and Cabinet to ensure the experts appointed by the Government to review the remaining sections of State Plan performance information are the most appropriate for the role.

I also recommended the Government formally respond to the 15 recommendations made by the Public Accounts Committee (PAC) on State Plan Performance Reporting in 2008. It did so in October 2010. I understand the PAC has not yet formally considered the Government's response.

Independent Verification of Performance Information in the Report– (Repeat issue)

I recommend the Government ensure that the systems generating the data used in the Report can be relied on.

The Government should ensure that the scope of the work performed by my Office and independent experts confirms the systems generating the data used in the Report have been appropriately designed and implemented, and have operated effectively throughout the period.

The Government has now engaged my Office to perform this work for certain performance data.

For more information on the Plan, refer to www.nsw.gov.au/stateplan.

Section Two

The Legislature

Members' Additional Entitlements

Audit Opinion

Members substantially complied with the requirements of the Parliamentary Remuneration Tribunal's (PRT) Determination for the year ended 30 June 2010.

Key Issues

Additional Temporary Staff

I recommend the Legislature redesigns the Additional Temporary Staff form to reflect actual hours worked by temporary officers and implement procedures to ensure the accuracy and completeness of the forms submitted.

The PRT Determination provides equipment, services and facilities that are necessary for Members to perform their Parliamentary duties. These include the Additional Temporary Staff (ATS) entitlement, which was introduced by Parliament in July 2006 as the Sitting Day Relief (SDR) entitlement. The SDR entitlement is used to finance the employment of additional temporary officers to assist Members of the Legislative Assembly at their electorate offices when electorate staff were at Parliament House on sitting days. The SDR entitlement was amended and renamed ATS in August 2007 to allow additional temporary staff to assist members on non-parliamentary day sittings as well.

Additional Temporary Staff are paid at an hourly rate equivalent to an Electorate Officer Grade 2. The Legislature does not have a system in place that ensures the hours worked by temporary officers are recorded on claim forms. The current Additional Temporary Staff claim form only records the number of days rather than hours worked.

In July 2010, the Independent Commission Against Corruption released a report on false claims made by a NSW Member of Parliament on SDR payments in 2006 - 07. This created the awareness on the need for accuracy of temporary staff claims.

Sydney Allowance

The Sydney Allowance is provided to Members who reside in non-metropolitan electorates to compensate for the additional costs associated with staying in Sydney to attend to Parliamentary business. A Member can choose to receive the Sydney Allowance as either an annual fixed allowance or a daily rate. The choice is made at the start of each financial year by each Member.

Members who receive their Sydney Allowance as an annual fixed allowance are required to return any unspent portion to Parliament by 30 September each year. Four Members did not return unused monies within the required time frame and the reconciliations for these Members were still outstanding at the time of our audit.

Year ended 30 June	Legislative Assembly			Legislative Council		
	2010	2009	2008	2010	2009	2008
Members receiving entitlement on an annual basis	23	25	22	6	8	7
Members' reconciliations submitted on time	20	22	21	5	8	7

Source: The Legislature

The PRT in its 2010 Determination introduced the following sanctions:

- suspension of annual entitlement and a reversion to a daily rate until reimbursement is made
- recommending Presiding Officers consider publishing the names of those Members who have not repaid the unused portion of their Sydney Allowance on time.

Internal Audit of Members' Additional Entitlements

As a result of the newly implemented self-assessment process for Members' additional entitlement claims, the Parliament introduced a specialised internal audit program that focused on the administration and management of varying aspects of the claims.

The findings of the internal auditors are summarised below.

Internal Audit Report Date (Period examined)	Findings
March 2010 (1 July 2009 to 16 October 2009)	Two moderate rated* issues relating to an invalid Logistic Support Allocation claim and misplaced leave application form. Five low rated** issues relating to missing documentation and administrative exceptions.
August 2010 (1 July 2009 to 28 February 2010)	Six moderate rated* issues relating to claims exceptions and insufficient documentation. Three low rated** issues relating to record keeping and content on Members' websites.

* Moderate rated - issue represents a control weakness, which could have or is having an adverse effect on the ability to achieve process objectives.

** Low rated - issue represents a minor control weakness, with minimal impact on the ability to achieve process objectives.

Other Information

Members' allowances are:

Entitlement for the year ended 30 June 2010	Expected expenditure *	Actual expenditure	Variance	Average expenditure per eligible member
	\$	\$	%	\$
Electoral Allowance	6,371,730	6,381,392	--	47,270
Sydney Allowance	1,988,910	1,678,433	16.0	25,822
Logistic Support Allocation	4,179,840	3,496,889	16.0	24,978
Electorate Mailout Account	5,898,463	4,370,854	26.0	46,498
Committee Allowance	19,531	16,961	13.0	2,423
Electorate Charter Transport Allowance	97,180	45,457	53.0	7,576
Travelling Allowance for Recognised Office Holders	a	--	--	--
Total	18,555,634	15,989,986	14.0	N/A

*Source: PRT Determination 2009.

N/A not applicable.

a Expected expenditure has not been provided as the maximum remuneration limit for this allowance is not defined.

A summary of maximum and minimum amounts claimed by entitlement type:

Entitlement for the year ended 30 June 2010	Maximum amount claimed/paid by an eligible Member \$	Minimum amount claimed/paid by an eligible Member \$
Electoral Allowance	82,095*	39,950*
Sydney Allowance	45,235	1,968
Logistic Support Allocation	61,966	10
Electorate Mailout Account	68,736	4,232
Committee Allowance	3,998	850
Electorate Charter Transport Allowance	15,931	291
Travelling Allowance for Recognised Office Holders	--	--

Source: PRT Determination 2009.

* The quantum of the electoral allowance is fixed depending on the geographical electoral grouping of the Member and paid with the monthly salary of the Member.

Electoral Allowance

The Electoral Allowance is provided to Members to assist with performing parliamentary duties including the cost of leasing or purchasing a motor vehicle.

Members	Electoral allowance payable per annum
Member of the Legislative Assembly	\$39,950 to \$82,095
Member of the Legislative Council	\$46,785

Source: PRT Determination 2009.

Sydney Allowance

The Sydney Allowance is given to Members whose principal place of residence is in a non-metropolitan electorate. The allowance compensates for the additional costs associated with staying in Sydney to attend sessions of Parliament, meetings of Parliamentary committees or other Parliamentary business. Additional costs include accommodation, meals and incidental costs.

In order to receive the allowance, each Member must certify, their principal place of residence to the Executive Manager, Department of Parliamentary Services.

The table below illustrates the daily rate and the number of nights that an eligible Member could claim for the year ended 30 June 2010:

Maximum allowable overnight stay*	Amount payable for overnight stay where accommodation costs are incurred *	In transit to and from Sydney where no over night stay is involved
From 105 – 180 nights	\$246	Actual reasonable expenses for meals and incidentals up to a maximum of \$77.55 per day

Source: PRT Determination 2009.

* If a Member chooses to receive the daily rate of allowance and the member exceeds the set number of overnight stays, he/she will be reimbursed actual costs, up to the daily maximum, upon production of tax invoices/receipts for each such occasion.

Committee Allowance

Committee Allowances are paid to Chairpersons of Joint, Select, and Standing Committees in recognition of the additional responsibilities of the office. Given the statutory nature of the Public Accounts Committee and its role in Government activities, an annual rate of allowance is payable to all Committee Members.

Range	Entitlement
Chairpersons of Joint, Select and Standing Committees	\$170 for each day that Parliament was not sitting
Public Accounts Committee Members	\$3,910 per annum

Source: PRT Determination 2009.

Electorate to Sydney Travel

Members of the Legislative Assembly and Legislative Council, who reside in particular electorate groups and zones, qualify for return air travel entitlement between their electorates/zones and Sydney as follows:

Categories	Electorate to Sydney Travel Entitlement (number of single journeys per annum)
Basic entitlement for all eligible members	104
Additional entitlement for office holders (Ministers of the Crown, Party Leaders, Presiding Officers and their deputies)	32
Additional entitlement for other officer holders (Deputy Leader of an eligible party and Deputy Leader of the Opposition)	16

Source: PRT Determination 2009.

Travel is restricted to economy class and is not transferrable between members, relatives, or Members' staff. Alternatively, the entitlement may be used to meet the cost of using a private or rental vehicle but must not exceed the cost of an economy airfare.

Logistic Support Allocation

Members and Recognised Office Holders of the Legislative Assembly and Legislative Council are entitled to this annual allocation as follows:

Member Type	Minimum allocation p.a. \$	Maximum allocation p.a. \$
Member and office holders of the Legislative Assembly	31,380	40,005
Member and office holders of the Legislative Council	21,285	32,470

Source: PRT Determination 2009.

Electorate Mailout Account

Members of the Legislative Assembly are provided with an annual amount to fund the cost of preparing and distributing newsletters to their electorate twice each year. The Electorate Mailout Account cannot be used for any other purpose. The table below shows the minimum and maximum entitlement for the year ended 30 June 2010.

Range	Annual entitlement
Minimum	\$57,459
Maximum	\$69,443

Source: PRT Determination 2009.

Members spent \$4.4 million in 2010 (\$4.7 million in 2009) of the total available allocation of \$5.9 million (\$5.9 million).

Electorate Charter Transport for Members of the Legislative Assembly

Members of the largest electorates are provided with the Electorate Charter Transport allowance to meet charter transport costs incurred within their electorates. Charter transport includes charter aircraft, vehicle costs and any other mode of transport deemed appropriate by the Speaker of the Legislative Assembly.

The allowance must only be used in connection with Parliamentary duties and cannot be used during election campaigns or for other electioneering or party political activities.

Members can receive between \$6,980 and \$21,080 a year.

Travelling Allowances for Recognised Office Holders

Recognised Office Holders such as the Premier, Deputy Premier and senior Ministers, receive a travelling allowance for all travel undertaken in relation to their role as a Recognised Office Holder. The allowance cannot be claimed when the Member travels on Parliamentary business in their own capacity.

Recognised Office Holders may also claim additional expenses exceeding the entitlement incurred by an approved relative who accompanied them to a State or official function.

Equipment, Services and Facilities

Parliament provides Members of the Legislative Assembly and the Legislative Council with the equipment, services and facilities necessary to perform their Parliamentary duties including:

- a fitted out, equipped and maintained office with secretarial services at Parliament House
- a fitted out, equipped and maintained Electorate Office for Members of the Legislative Assembly
- equipment and ancillary services in the Member's private residence including a telephone and facsimile machine, for the performance of Parliamentary duties
- administrative support from Presiding Officers:
 - two electorate staff for each Legislative Assembly Member
 - one additional staff for each Independent Legislative Assembly Member
 - entitlement to recruit additional temporary staff to work at electorate office or Parliament House for a period of 61 days per annum
 - one staff member for each Legislative Council Member
 - two staff members for each Legislative Council Member who is elected as a cross bench Member, but not a Minister
 - one staff member for each Whip of a recognised political party of not less than 10 Members.

The Role of the Parliamentary Remuneration Tribunal

The Tribunal's principal function is to determine 'additional' entitlements available to Members of Parliament.

These additional entitlements fall into two categories:

- Those in the nature of allowances:
 - Electorate Allowance
 - Sydney Allowance
 - Committee Allowance

- Those in the nature of fixed allocations:
 - Electorate to Sydney travel
 - Logistic Support Allocation
 - Electorate Mailout Account for Members of the Legislative Assembly
 - Electorate Charter Transport for Members of the Legislative Assembly
 - Travelling allowance for Recognised Office Holders
 - Equipment services and facilities.

The Legislature pays the additional entitlements where Members incur the actual costs. It can either reimburse the Member or pay third parties (e.g. travel providers) for services to the Member.

The additional entitlements determined by the PRT are separate to:

- Members' annual basic salaries, set by the *Parliamentary Remuneration Act 1989* (the Act)
- additional salaries paid to Ministers and certain other office holders, set out in Schedule 1 of the Act as varying percentages of their basic salaries
- expense allowances paid to Ministers and certain other office holders, set out in Schedule 1 of the Act as varying percentages of their basic salaries.

Comments on the Legislature were reported in Volume 8 of my 2010 Auditor-General's Report to Parliament.

Section Three

Commentary on Government Agencies

Overview of 2010
Electricity Sale Transactions
Waste Recycling and Processing Corporation

Overview of 2010

26

NSW Auditor-General's Report

Volume One 2011

OVERVIEW OF 2010

Last year, I tabled 11 financial audit reports and 17 performance audit reports in the New South Wales Parliament. Financial audit reports are discussed below and performance audit reports are discussed later in this overview.

Financial Audit Reports

My 2010 financial audit volumes, and the sectors they related to, were as follows:

Volume 1 – Containing 30 June 2009 audit results not included in the 2009 volumes

Volume 2 – Universities

Volume 3 – Total State Sector

Volume 4 – Electricity

Volume 5 – Public Financing Enterprises

Volume 6 – Human Services and Technology

Volume 7 – Environment, Climate Change & Water

Volume 8 – Law & Order and Emergency Services

Volume 9 – Transport, Planning and Industry

Volume 10 – Education and Communities

Volume 11 – Health and Ports

Contained in these 2010 volumes were 247 significant items and 270 recommendations. I will review the implementation status of these recommendations during 2011. During 2010 I noted that a majority of my 2009 financial audit recommendations were actioned or partially implemented (Volume 3, page 13).

The information in this overview has been drawn and collated from my 2010 financial audit report volumes Three to Eleven, which focussed on the 30 June 2010 audits. The 202 recommendations in these volumes are analysed in this overview.

In this overview, I summarise the key themes and messages from my audits. This will assist readers understand the common findings arising from my audits and could also be used by agencies and their audit committees to guide a self assessment to identify issues that may be relevant to their organisation.

The Audit Office undertook 495 financial audits last year and I included commentary and analysis on 141 significant agencies in my 2010 financial audit volumes. This coverage is sufficient to identify common themes that apply across government.

In those audits, I conducted a review of human resource issues across agencies focussing on contract staff, excessive overtime, management of annual leave and flex leave, and the age profile of employees. Many of my recommendations were made in the human resources area and the results of this review are summarised in this report.

An important component of my financial audits is my review of controls over agency computerised information systems. I have also included in this report an overview of common issues identified from my information system audits.

Administrative Restructure

In 2009, the New South Wales Government announced a comprehensive reform of the public sector, amalgamating 160 government agencies and offices into 13 new clusters containing 12 principal or 'super' departments. These clusters, the principal departments and some of the other bodies in each cluster that remain separate reporting entities for statutory and other purposes are as follows:

Cluster	Principal Department	Other Bodies
Communities NSW	Communities NSW	Arts, Sports and Recreation bodies, Sydney Cricket & Sportsground Trust, NSW Institute of Sport
Education & Training	Department of Education and Training	TAFE Commission, Institute of Teachers, Board of Studies
Environment, Climate Change & Water	Department of Environment, Climate Change and Water	Catchment Authorities, Water Corporations, Jenolan Caves Reserve Trust, Zoological Parks Board
Health	Department of Health	Area Health and Ambulance Services, Cancer Institute, Justice Health
Human Services	Department of Human Services NSW	Housing NSW, Aboriginal Housing, Home Care Service of NSW, Businesslink Pty Ltd
Industry & Investment	Department of Industry and Investment	Primary Industries, Energy Corporations, Food and Rural Assistance Authorities
Justice & Attorney General	Department of Justice and Attorney General	NSW Trustee and Guardian, Information and Privacy Commission, Legal Aid Commission, Industrial Relations, Director of Public Prosecutions
Planning	Department of Planning	Luna Park, Sydney Harbour Foreshore Authority, Barangaroo Delivery, Land and Property Management Authority
Police & Emergency Services*	None	NSW Police Force, Fire Brigades (now Fire and Rescue NSW), NSW Rural Fire Service, State Emergency Service, Crime Commission
Premier & Cabinet	Department of Premier and Cabinet	Ministry for Police, Local Government, Women's Policy, Veterans Affairs, ICAC, IPART, Ombudsman, Police Integrity Commission
Services, Technology & Administration	Department of Services, Technology & Administration	Rental Bond Board, State Records Authority, Internal Audit Bureau
Transportation	Transport NSW	RTA, RailCorp, State Transit, Sydney Metro, Sydney Ferries, Transport Construction Authority and Port Corporations
Treasury	The Treasury	Financial Management, State Revenue, Self Insurance, Compensation Authorities, TCorp, Pillar

* This cluster was abolished but we have grouped these agencies for reporting purposes in this Overview.

As a result of the restructuring process, government agencies have undergone substantial changes since the completion of the 2008-09 reporting period.

I made 202 recommendations in my 30 June 2010 financial audit volumes to improve the performance of New South Wales Government agencies, 46 of which were repeat recommendations

New South Wales Parliament's Public Bodies Review Committee has highlighted the challenges faced by the principal departments in adapting their performance evaluation and annual reporting processes to incorporate any new areas of responsibility. Complex agencies have a particularly onerous task in presenting a large volume of information in a format that is clear, concise and meaningful to an audience with a widely varied range of information needs and levels of interest. I will continue to work with agencies to address these challenges.

For further details on the allocation of New South Wales Government agencies to clusters refer to the following websites:

www.directory.nsw.gov.au/departments.asp

www.dpc.nsw.gov.au/publications/news/stories/allocation_of_bodies_to_super_departments

Recommendations in 2010 Reports to Parliament

I made 202 recommendations in my 30 June 2010 financial audit volumes to improve the performance of New South Wales Government agencies, 46 of which were repeat recommendations. The recommendations and the clusters they relate to were as follows:

Cluster	Number of Agencies in Cluster ¹	Number of Recommendations	Repeat Recommendations
Health	53	62	34
Transportation	25	34	3
Communities NSW	32	18	1
Human Services	15	17	4
Environment, Climate Change & Water	43	16	0
Justice & Attorney General	13	13	0
Planning	23	12	4
Police & Emergency Services	8	10	0
Industry & Investment	44	10	0
Services, Technology & Administration	14	3	0
Education & Training	17	4	0
Treasury	37	3	0
Premier & Cabinet	16	0	0
Total	340	202	46

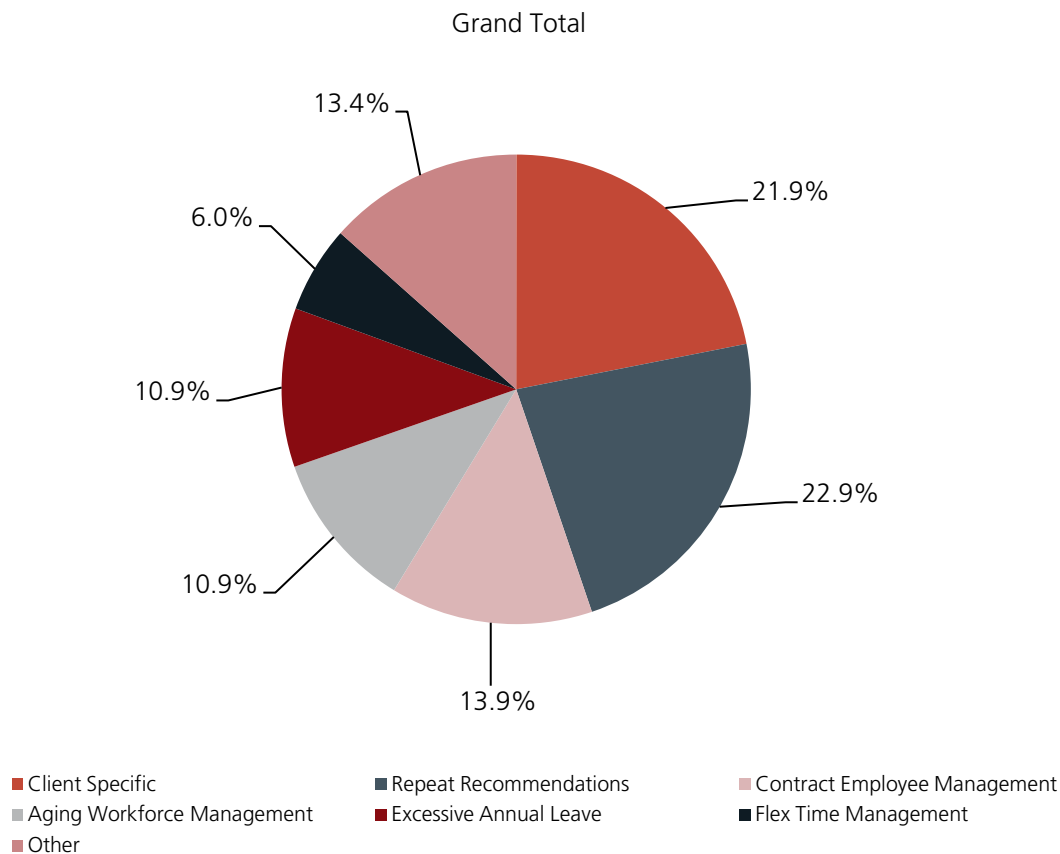
¹ Represents the number of reporting entities in the cluster with 30 June year ends only

In the table above, a significant number of recommendations and repeat recommendations were in the Health cluster. The large number of repeat recommendations related to the following areas: accounts payable and creditor management; effectiveness of the budget monitoring processes; management of plant and equipment including medical equipment; management of trust funds; development of Key Performance Indicators for its service centres; and general internal control deficiencies. The NSW Department of Health has advised they have progressed in implementing a number of the recommendations.

For further details, refer to my Financial Audit Volume 11.

Common Audit Recommendations

Common themes identified from the 202 recommendations made in my financial audit volumes that related to 30 June 2010 audits are as follows:



Client specific recommendations in the chart above concern those recommendations made to individual agencies that cannot be grouped into a particular theme. These are not analysed in this report but were separately highlighted in my 2010 Volumes. The nature of repeat recommendations has been discussed earlier in this section.

A significant number of recommendations were made in the human resources area in 2010. These are summarised in the following paragraphs.

Contract Employee Management

I recommended that agencies:

- create and maintain a single register of all contract employees
- periodically review the roles and responsibilities of all contract employees to ensure:
 - reliance on contract employees is not excessive
 - use of contract employees instead of permanent employees is appropriate
 - contractors do not become de facto employees by virtue of being with the agency for an extended period of time
 - use of contract employees continues to represent value for money.

I identified:

- high numbers of contract employees with limited evidence of an appropriate management review system operating
- contract employees being engaged for long periods of time. A number of contract employees were identified as being engaged for over three years and as high as 11 years

A significant number of recommendations were made in the human resources area in 2010.

I made 27 recommendations regarding contract employee management to individual agencies in 11 out of 13 clusters.

I made 22 recommendations regarding managing an ageing workforce to agencies in seven out of 13 clusters.

- significant numbers of contract employees being engaged for more than \$1,000 per day some earning over \$400,000 per annum.

While, the use of contract employees may have benefits for entities, particularly on projects or where specialist skills are needed, extensive reliance on this employment source and the engagement of long term contract employees, particularly in senior roles, generally results in higher employment costs and less ownership and commitment to organisational goals and objectives.

Aging Workforce Management

I recommended agencies continue to develop and implement effective policies to manage their ageing workforce.

I made 22 recommendations regarding managing an ageing workforce to agencies in seven out of 13 clusters. The following table shows the percentage of employees over 50 and over 55 years of age in each of the clusters:

Cluster	Number of Agencies in Cluster ¹	Number of Agencies Analysed ²	Total Number of Employees Analysed ²	% of Employees Aged Over 50 Years ^{2 & 3}	% of Employees Aged Over 55 Years ^{2 & 3}
Education & Training	17	2	53,602	46.5	25.2
Human Services	15	5	11,481	46.3	25.0
Planning	23	3	1,967	45.0	27.4
Services, Technology & Administration	14	1	3,500	43.0	25.0
Industry & Investment	44	1	3,572	40.0	24.0
Justice & Attorney General	13	3	13,794	39.3	24.3
Health	53	20	93,335	39.0	22.1
Transportation	25	15	29,386	39.0	23.0
Communities NSW	32	8	2,583	37.1	19.4
Environment, Climate Change & Water	43	5	8,265	36.7	20.9
Treasury	37	1	1,301	36.0	22.0
Premier & Cabinet	16	1	903	26.9	7.6
Police & Emergency Services	8	1	18,955	20.2	10.1
Total ⁴	340	66	242,644	39.5	22.2

1 Represents the number of reporting entities in the cluster with 30 June year-ends only

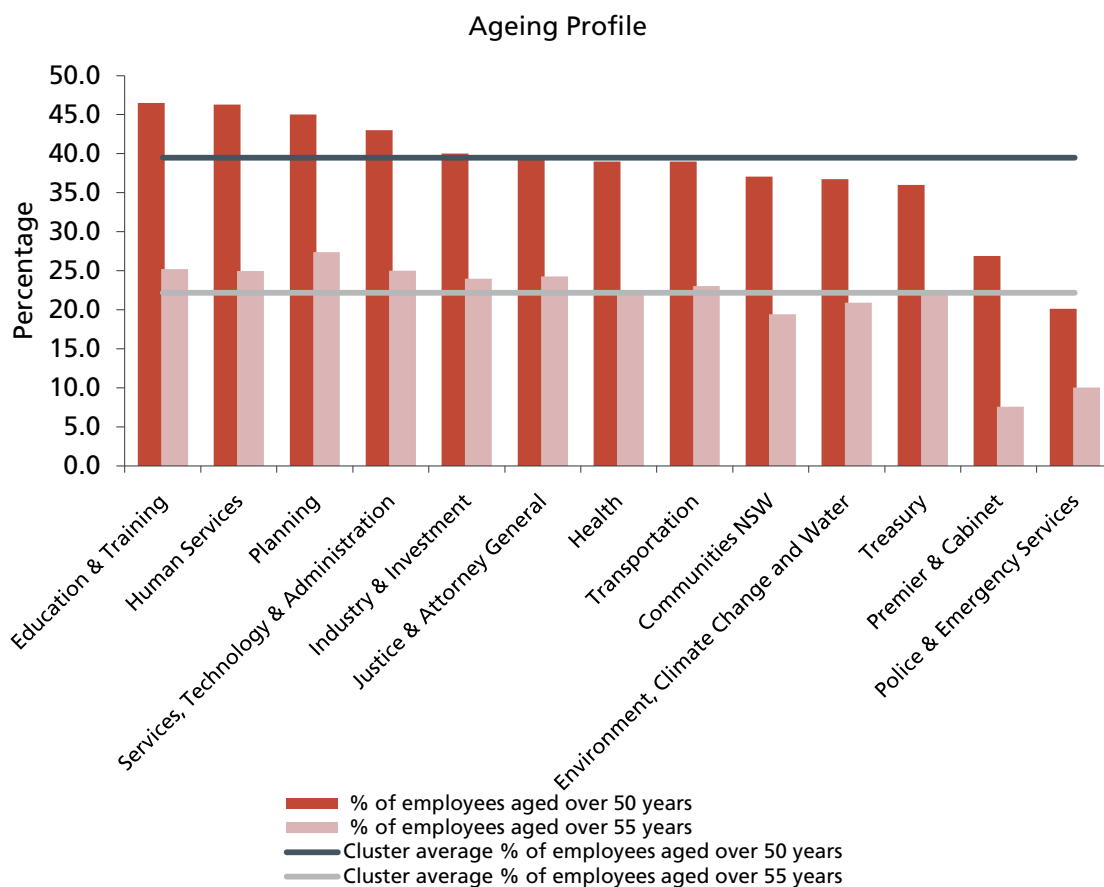
2 Represents significant agencies reported and analysed in Auditor-General's 2010 Financial Audit Report Volumes 3-11. Human resources details were not reported on for agencies where there were no significant findings as a result of our analysis.

3 The percentage is based on the weighted average of those agencies analysed within each cluster.

4 According to the New South Wales Department of Premier and Cabinet's 2009-10 Workforce Profile Snapshot Report there were 317,233 full time equivalent public sector employees in 2010. The number of employees noted in the table above is based only on the significant agencies analysed and reported in our 30 June 2010 financial audit volumes.

The table above shows that the percentage of employees over 50 is most pronounced in the Education & Training cluster and least pronounced in those agencies we have grouped as Police & Emergency Services.

The following table shows how the individual clusters compare to the average of all clusters, being 39.5 per cent of employees over 50 years of age and 22.2 per cent over 55 years of age:



To ensure an adequate supply of employees in the future, agencies should continue to actively monitor workforce age profiles and have appropriate strategies in place to develop, attract and retain employees whose skills are aligned with the strategic direction of the agency.

Many agencies have made efforts to respond to the trends identified with a more comprehensive human resources strategy. The full impacts of such strategies are yet to be seen.

I made 22 recommendations regarding excessive annual leave balances to agencies in 11 out of 13 clusters.

Excessive Annual Leave

I recommended entities review the effectiveness of their policies for managing excessive annual leave balances.

I made 22 recommendations regarding excessive annual leave balances to agencies in 11 out of 13 clusters. The following table shows the percentage of employees with more than 40 days of annual leave accrued within individual clusters:

Cluster	Number of Agencies in Cluster ¹	Number of Agencies Analysed ²	Total Number of Employees ²	Number of Employees With Leave Over 40 Days ²	% of Total Employees ²
Police & Emergency Services	8	2	26,098	7,133	27.3
Health ³	53	20	93,335	23,833	25.5
Justice & Attorney General	13	3	13,794	2,756	20.0
Environment, Climate Change & Water ⁴	43	5	9,032	1,737	19.2
Human Services	15	5	13,035	1,768	13.6
Industry & Investment	44	2	4,412	568	12.9
Premier & Cabinet	16	1	903	105	11.6
Communities NSW	32	8	2,678	292	10.9
Planning	23	2	855	88	10.3
Transportation	25	13	29,215	2,165	7.4
Services, Technology & Administration	14	1	3,500	137	3.9
Education & Training	17	3	53,847	1,489	2.8
Treasury	37	2	2,839	64	2.3
Total ⁵	340	67	253,543	42,135	16.6

1 Represents the number of reporting entities in the cluster with 30 June year-ends.

2 Represents significant agencies reported and analysed in Auditor-General's 2010 Financial Audit Report Volumes 3-11. Human resources details were not reported on for agencies where there were no significant findings as a result of our analysis.

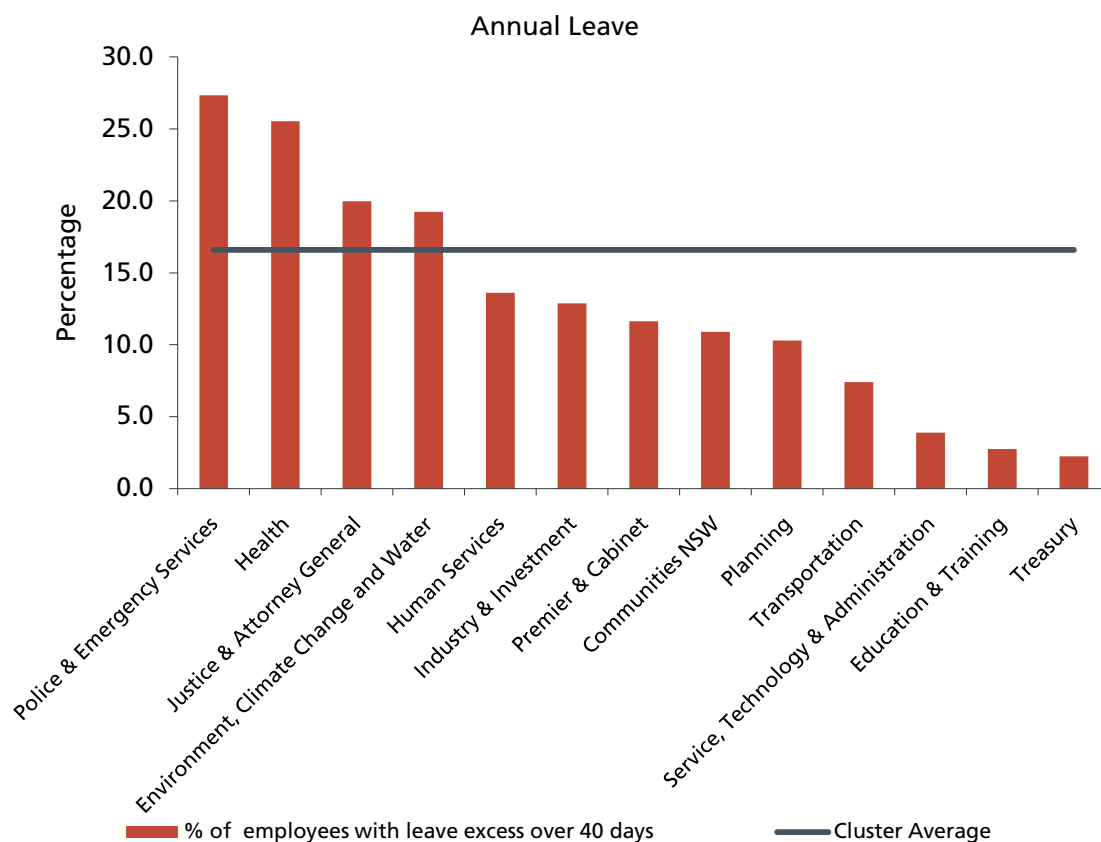
3 A significant number of Health staff attract award entitlements of six weeks annual leave per annum, with entitlements increasing further depending on the incidence of time worked on Sundays and public holidays. In such instances, and using the public sector benchmark of two years accrual as a guide, its staff may not be in an excess leave position until the accrual exceeds 70 days.

4 A significant number of staff in the Department of Environment, Climate Change and Water (1,296 at 30 June 2010) accrue additional annual leave (above 20 days) as compensation for working week-ends or public holidays, or residing in the Western or Central Districts of NSW, and therefore the benchmark may not be appropriate for those staff.

5 According to the New South Wales Department of Premier and Cabinet's 2009-10 Workforce Profile Snapshot Report there were 317,233 full time equivalent public sector employees in 2010. The number of employees noted in the table above is based only on the significant agencies analysed and reported in our 30 June 2010 financial audit volumes.

The table above shows that the percentage of employees with more than 40 days of leave is most pronounced in the Police & Emergency Services and Health clusters. It should be noted that some Health workers are actually entitled to up to six to seven weeks of annual leave a year.

The following graph shows how the individual clusters compare to the average, which is 16.6 per cent of employees having more than 40 days leave:



Whilst there have been many examples where agencies have improved leave management practices and managed to reduce leave balances progressively over the past few years, I identified:

- instances where the management of leave is decentralised and not monitored at the executive level
- many instances where employees had over 200 days of annual leave accumulated and, in one case, 277 days
- many agencies that do not have leave management plans in place for employees with significant leave balances
- agencies where over one quarter of employees had more than 40 days annual leave accumulated
- agencies where the annual leave balances continue to increase year-on-year.

Excess leave entitlements can have adverse effects, including an ever increasing financial liability as salary rates increase over time. Large leave balances expose entities to significant payouts when employees leave the organisation.

The health and welfare of staff can also be adversely affected if they do not take sufficient breaks from work during the year.

I made 12 recommendations regarding managing flex time to agencies in eight out of 13 clusters.

I made six recommendations regarding managing overtime to agencies in four out of 13 clusters.

Allowing excess annual leave balances also means employees performing key control functions may not be rotated regularly, which is a preventive control against fraud. Requiring employees to regularly take annual leave acts as a control mechanism to minimise fraud as fraudulent activities may be detected when perpetrators are on leave.

Entities need to manage excessive annual leave balances on an ongoing basis and maintain appropriate systems so that employees take annual leave regularly and that excessive accumulations do not occur.

Flex Time Management

I recommended agencies each implement a centralised system for monitoring flex leave arrangements and ensure excessive flex time is not being accrued and forfeited by staff.

In my analysis of flex time management, I identified many instances whereby flex time was accumulated and forfeited by staff. This trend was prominent in agencies with a decentralised record keeping structure and manual approach to the maintenance of flex records.

The majority of agency staff are employed under flexible work practices. However, flex records at many agencies were decentralised and not managed at the corporate level. Accordingly, the extent to which flex time is accrued and used, and the balance accumulated by staff at 30 June 2010 was not able to be provided by many agencies. If not effectively managed, employees may be accruing and/or forfeiting excessive flex time.

Overtime Management

I recommended many agencies review the effectiveness of their existing policies for managing overtime work and analyse the underlying reasons for overtime payments that are significantly more than base pay.

I identified:

- an instance where an agency's overtime bill was \$128 million with more than 413 employees being paid 50 percent or more of their annual salary in overtime
- instances where employees received overtime payments higher than their base salary.

On the other hand, one agency has reduced its overtime costs to \$32.8 million from \$40.7 million, as well as the number of staff earning more than 50 percent of base salary in overtime from 232 to 114.

The following table shows the average overtime received by employees within individual clusters:

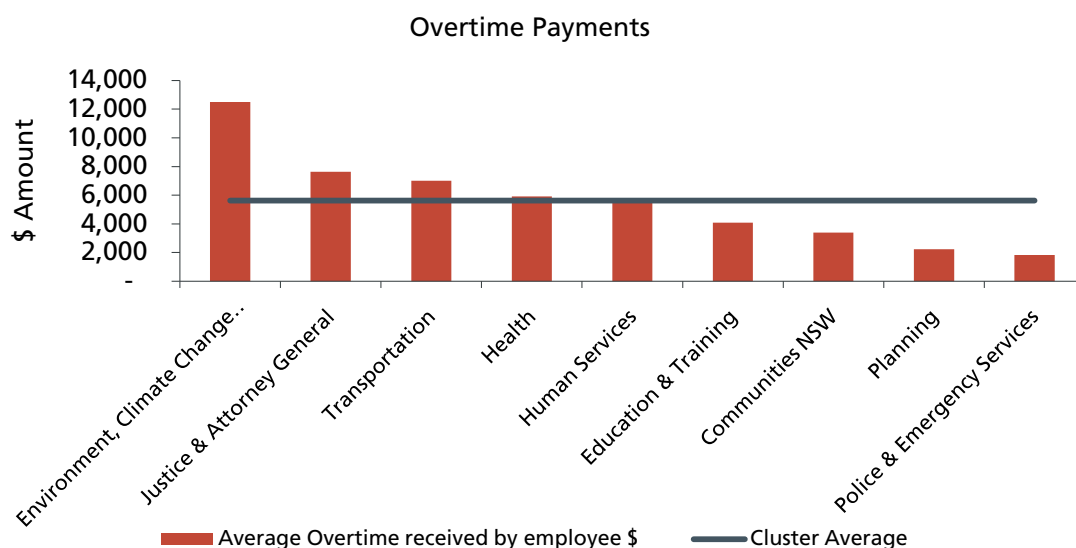
Cluster	Number of agencies in cluster ¹	Number of agencies analysed ²	Total overtime paid \$'000 ²	Number of employees receiving overtime ²	Average overtime received by employee \$ ²
Environment, Climate Change & Water	43	4	27,658	2,214	12,492
Justice & Attorney General	13	2	33,255	4,354	7,638
Transportation	25	12	218,491	31,138	7,017
Health	53	20	341,000	57,681	5,912
Human Services	15	2	36,368	6,287	5,785
Education & Training	17	2	26,300	6,448	4,079
Communities NSW	32	2	581	171	3,400
Planning	23	1	18	8	2,234
Police & Emergency Services	8	1	35,300	19,390	1,821
Industry & Investment	44	--	--	--	--
Premier & Cabinet	16	--	--	--	--
Services, Technology & Administration	14	--	--	--	--
Treasury	37	--	--	--	--
Total	340	46	718,971	127,691	5,631

1 Represents the number of reporting entities in the cluster with 30 June year ends.

2 Represents significant agencies reported and analysed in Auditor-General's 2010 Financial Audit Report Volumes 3-11. Human resources details were not reported on for agencies where there were no significant findings as a result of our analysis.

The table above shows that employees in the Environment cluster received the highest overtime payments on average. The agencies reported as part of the Environment cluster include Water Corporations which, as State Owned Corporations, fall outside the responsibility of the principal department, the Department of Environment, Climate Change and Water.

The graph below shows how the individual clusters compare to the average overtime amount of \$5,631.



Managing overtime expenditure continues to be a challenge for some agencies. While some are making progress in reducing overtime, overtime continues to represent a significant employee related expense. Overtime can be a cost-effective approach to providing services in areas of low demand (like night time or rural areas), but needs to be managed carefully.

High levels of overtime can adversely affect financial and operational performance. Financially, premiums paid for overtime can lead to higher than necessary costs, while operationally, employees working high levels of overtime may result in health and safety issues.

Effectiveness of Internal Controls

Each agency is responsible for developing and maintaining an adequate system of internal control to ensure that financial records and other information are complete and accurate, assets are adequately safeguarded, and errors and other irregularities are prevented or detected. Internal control procedures reduce variations in processes and procedures, leading to more predictable outcomes.

A good system of internal controls substantially reduces the risk of fraud and error and provides assurance to management and auditors that the amounts reported in entities' systems and financial statements are materially correct.

An integral part of the audit process is assessing the adequacy of an entity's internal control processes and identifying any weaknesses. In accordance with Australian Auditing Standards, these weaknesses and our recommendations for improvement are brought to the attention of management.

Weaknesses in internal controls identified during an audit will not necessarily result in a qualified auditor's opinion on an agency's financial statements. Often there are other control procedures in place that compensate for these weaknesses. Audit processes can be used to determine the level of risk of a material error occurring. A qualified auditor's opinion may only be required where a lack of appropriate internal controls causes significant uncertainty about the financial information being reported.

Management Letters to Agencies

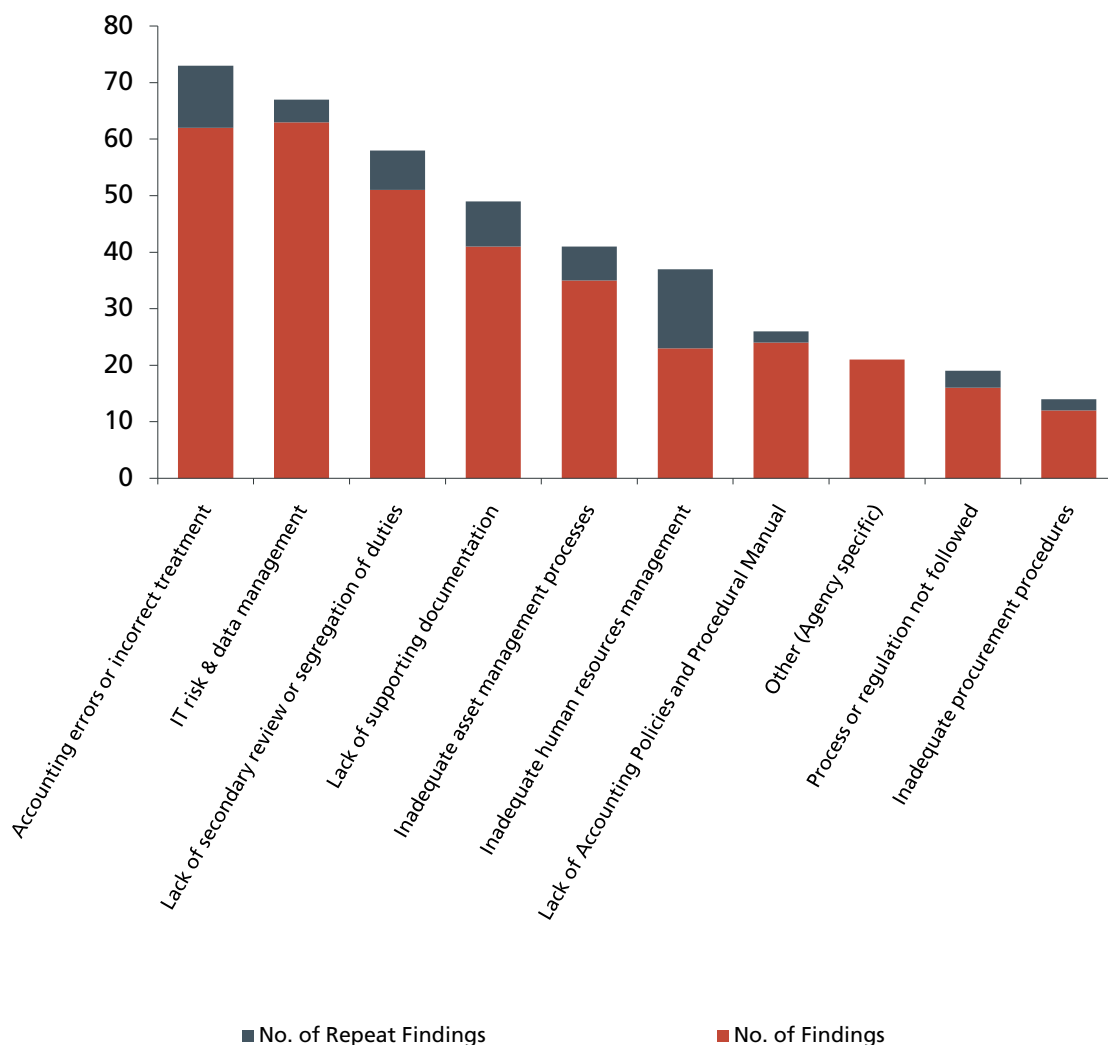
In addition to making recommendations to agencies in my reports to Parliament, I also provide management letters to agencies outlining my observations and recommendations identified in the current year's audit. The management letter also includes those issues identified in previous audits which have not been satisfactorily resolved by management (repeat issues).

Management letters are addressed to the Chief Executive Officer/Department Head or Chair of the Board (where applicable).

I analysed the recommendations made to 69 out of 345 agencies with a 30 June 2010 year end. This sample included a selection of large and small agencies. A total of 405 issues and recommendations were analysed. As a result, I identified a number of common issues where improvements need to be made across a number of agencies. These common issues are summarised in the table below:

The top three common issues raised in my management letters to agencies related to accounting errors or incorrect treatment, IT risk and data management, and the lack of secondary review or segregation of duties.

Common Management Letter Issues



I have identified that many smaller agencies, with limited resources, have difficulties in establishing and maintaining effective systems of internal control as well as in compliance with laws and regulations.

The New South Wales Government should consider, when establishing agencies, that they have sufficient resources and expertise (or access to them) to comply with the requirements of the *Public Finance and Audit Act 1983* and other legislation and regulations.

There appears to be a shortage of suitably qualified finance personnel in many agencies to establish and maintain robust internal control environments, correctly interpret accounting standards and produce quality financial statements. Agencies should review their human resources strategy to retain and attract skilled personnel.

The graph above is analysed in the following paragraphs.

Accounting Errors or Incorrect Accounting Treatment

Of the 405 management letter issues reported to management over 70 were related to accounting misstatements, incorrect accounting treatment or deficiencies in financial statement disclosures. Misstatements occurred most frequently in agencies that do not undertake secondary reviews of main reconciliations, lack supporting documentation for account balances, or do not have appropriate segregation of duties.

This indicates, in many agencies, misstatements are the result of a combination of control weaknesses. If not addressed properly, the potential for misstatements in reported results and fraud is increased. Agencies must proactively address business process level controls to establish effective internal control environments.

IT Data and Risk Management

The next most common management letter theme is inadequate IT control environment management. This encompasses the agency's process for addressing IT Security, Data Centre Management, and IT user management. For further details, refer to the Information System Audit section later in this overview.

Lack of Secondary Review

Many agencies lack secondary review and approval of transactions and documentation. For example, reconciliations are not reviewed by independent officers, changes to financial systems such as accounts payable data and payroll master files are not monitored. Intentional or unintentional errors in the data can have a large effect on the accuracy and validity of transactions. It is, therefore, important that there is adequate management oversight for independent checking and verification.

Segregation of Duties

A number of agencies were unable to maintain satisfactory segregation of incompatible duties in the revenue, payments and payroll areas due to their small size. Whether by design, or because of resource constraints, a lack of segregation of duties increases exposure to fraud by providing opportunity, without any checks and balances to detect such activity.

Lack of Documentation

Many agencies were found to not have adequate documentation to support management's assertions for significant account balances. This encompasses a lack of reconciliation between general ledgers and subsystems, incorrect reconciliations, reconciling differences not cleared or explained, and no documentation to support account balances.

Inadequate Asset Management

Many agencies do not have adequate controls around managing assets, from acquisition, to recording, depreciation, revaluation and disposal. The Audit Office undertook a compliance review on Total Asset Management (TAM) at selected agencies in 2009. None of the agencies reviewed fully complied with the Government's TAM requirements. I identified material issues which resulted in qualification of my compliance review report for each agency.

Refer to the following link for further details:

www.audit.nsw.gov.au/publications/reports/financial/2009/vol12/pdf/06_compliance_review_report_-_total_asset_management_volume_12_2009.pdf

Inadequate Human Resources Management

I conducted a review of human resource issues across agencies, focussing on contract staff, excessive overtime, management of annual leave, the employee age profile and management of flex leave in 2010. There were a large number of repeat findings in this category. The results of this review were summarised earlier in this report.

Accounting Policies and Procedural Manual

A number of agencies lack or fail to update formal accounting manuals and policies and procedures, including a formal fraud control plan. Having up-to-date accounting policy and procedural manuals is necessary for establishing an effective control environment.

Agency Specific Issues

Over 20 recommendations were specific to individual agencies, and there is no emerging common theme from them. I do not comment in this overview on agency specific issues.

Process/Regulation not followed

Many entities received a recommendation for not correctly following policies and procedures, inappropriate expenditure approval levels, or non compliance with legislative requirements or Treasurer's directions. If the procedures set out in the accounting manual are not followed, the potential for fraud is increased.

Inadequate Procurement Procedures

A small number of agencies had issues relating to expenditure and accounts payable controls including procurement practices, inadequate checking of expenditure transactions processed, lack of controls in managing purchase orders and receipting goods.

Elsewhere in this volume are the results of my e-procurement compliance review.

Quality and Timeliness of Financial Reporting

I recommended the Premier and the Treasurer implement the recommendations of the Public Accounts Committee relating to the quality and the timeliness of financial reporting and ensure they have appropriate policies and processes to support the successful implementation of the recommendations.

In previous years I have expressed concerns about the quality and timeliness of financial reporting. While I recognise that events occur after the Budget is tabled in early June, I believe improved financial information would better inform the budget process and reduce subsequent variations and revisions.

The quality and timeliness of the General Government and Total State Sector Accounts is largely dependent on:

- the quality and timeliness of financial information provided by agencies
- The Treasury's year end processes including coordination and guidance to agencies
- the competency of those preparing and providing financial information.

Most agencies were required to submit their 30 June 2010 financial statements to the Audit Office by 11 August 2010 and the audits were to be completed within 10 weeks, or by 20 October 2010.

The table below details the number of audit opinions signed on agencies' 30 June 2010 financial statements by month and by cluster in 2010.

Cluster	August	September	October	November	December	Outstanding	Total
Communities NSW	1	2	28			1	32
Education & Training		5	10			2	17
Police & Emergency Services			8				8
Environment, Climate Change & Water		8	31		2	2	43
Health		11	21	5	3	13	53
Human Services		1	13			1	15
Industry & Investment		20	20	1		3	44
Justice & Attorney General	1		10			2	13
Planning		2	15	5		1	23
Premier & Cabinet		5	9	2			16
Services, Technology & Administration			14				14
Transportation		3	22				25
Treasury	1	12	20	4			37
Total ¹	3	69	221	17	5	25	340

¹ The table above excludes University audits which have a 31 December year end and the Total State Sector financial statements which are a consolidation of individual agencies.

The table above shows that 65 per cent of my audit opinions on agencies' 30 June 2010 financial statements were signed in October and 14 per cent were signed from November onwards. At the end of the year, 25 (7 per cent) of my audit opinions had not been signed and about half of those outstanding were various Registration Boards in the Health cluster.

The financial reporting and audit processes for these Boards were delayed as a result of changes arising from the abolition of the entities and transition to a national scheme of registration.

The two outstanding audits in the Justice and Attorney General cluster were request audits which have no statutory deadline for completion.

The production of high quality and timely financial reports by agencies is essential for Government decision making and effective delivery of services. It also enhances public sector accountability.

During 2009-10, The Treasury piloted a 'hard close' initiative to improve the quality and timeliness of financial reporting. Because the initiative was only partially implemented by some of the piloted agencies, it is difficult to determine how successful the initiative was. However, I firmly believe the full implementation of hard close procedures across the sector will result in improved quality and timeliness of financial reporting.

In October 2010, the Public Accounts Committee released a report on the Quality and Timeliness of Financial Reporting. The Committee recommended:

- the Treasurer require all agencies to conduct a hard close of their accounts at 31 March from 2011
- the Treasurer propose amendments to the *Public Finance and Audit Act 1983* requiring chief financial officers to certify their financial reporting systems
- the Premier ensure that accountability for accurate and timely financial reporting is included in all chief executive officers' performance agreements
- the Treasurer develop and implement a program to bring forward the deadline for the tabling of annual reports in Parliament to three months after the end of the financial year by 2013 at the latest
- the Treasurer consider proposing amendments to prescribe minimum qualifications of chief financial officers in the *Public Finance and Audit Act 1983*.

Implementing the recommendations will pose significant challenges for The Treasury, my Office and Government agencies, which need to be addressed.

In response to the recommendations, the Treasury has strongly encouraged larger agencies to implement early close procedures for 2011. Treasury Circular 11/01 'Early Reporting Program – Strategy to improve the quality and timeliness of financial statements and Annual Reports' sets out a number of procedures for agencies to perform before 30 June 2011 to improve the quality and timeliness of financial statements.

In 2010, the Treasury wrote to agencies about the need to certify financial systems. In February 2011, the Treasury wrote again providing greater detail as to the certification. The certification will confirm whether agencies have effective systems, processes and internal controls to ensure financial information provided to the Treasury is relevant and reliable. In order for agencies to table their annual reports by 30 September each year (three months after year-end), the Audit Office will need to complete financial audits before that date. In 2010, I issued 72 or 21 per cent of our audit opinions by 30 September.

Audit Opinions

I issued audit opinions based on the results of my audit procedures on 30 June 2010 financial statements. The types of opinions that I issued included the following:

Unqualified opinion: the opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the financial reporting standards.

Qualified opinion: the opinion expressed when the auditor concludes that the financial statements are materially misstated or when the auditor is unable to obtain sufficient appropriate audit evidence to support an unqualified opinion.

Emphasis of matter: a paragraph included in the auditor's report to highlight a matter affecting the financial statements. This does not affect the auditor's opinion.

In the following table I have summarised the types of audit opinions that were issued for completed financial statement audits for 30 June 2010 by cluster.

Cluster	Unqualified	Qualified	Emphasis of matter	Outstanding	Total
Communities NSW	30	1		1	32
Education & Training	15			2	17
Police & Emergency Services	8				8
Environment, Climate Change & Water ¹	39	1	1	2	43
Health	38	2		13	53
Human Services	13		1	1	15
Industry & Investment	37		4	3	44
Justice & Attorney General	11			2	13
Planning	19	1	2	1	23
Premier & Cabinet	16				16
Services, Technology & Administration	13		1		14
Transportation	25				25
Treasury	33	3	1		37
Total	297	8	10	25	340

¹ The qualified independent audit report was provided to a Water Corporation.

The reasons for the qualified opinions were:

- an inability to obtain all relevant information required to recognise and value certain assets
- an inability to conclude on the completeness of income from voluntary contributions to trusts and charities
- agencies incorrectly applying accounting standards.

Financial Reporting Systems

Last year I recommended that The Treasury and Department of Premier and Cabinet take lead roles in monitoring, supporting and reporting on the implementation of common financial reporting and support systems within the new principal departments.

During my audits of amalgamated agencies I identified:

- some agencies are yet to make significant progress on implementing common financial reporting and support systems to leverage synergies expected from the amalgamations
- additional costs associated with the amalgamations are not readily identifiable
- systems have not been put in place to capture and report cost savings associated with the initiative
- seven of the 24 largest agencies' financial statements for the year ended 30 June 2010 submitted for audit contained 24 errors exceeding \$20.0 million.

The financial reporting process is complicated by the structure and number of reporting entities in the New South Wales public sector. The Public Accounts Committee has recognised the challenges faced by principal departments following the reorganisation in reporting comprehensively and succinctly on several diverse functions. If we consider the objective of improving the timeliness of Government reporting, these changes represent a real challenge to the public sector.

The importance of implementing quality financial reporting systems is further emphasised when the number and dollar value of misstatements, corrected and uncorrected, identified in my 30 June 2010 financial audits is considered. I identified 957 misstatements of which 510 needed to be corrected by the agencies before I could issue my audit opinions. There will need to be a significant reduction in the number of misstatements if the public sector is going to improve the timeliness of its reporting.

Four out of 13 clusters had more than 100 individual misstatements. I have summarised these errors by cluster in the table below:

I identified 957 misstatements of which 510 needed to be corrected by the agencies before I could issue my audit opinions.

Clusters	Number of agencies in cluster ¹	Number of corrected misstatements	Number of uncorrected misstatements	Total	Number of misstatements per agency (average) ²
Planning	23	65	48	113	5
Justice & Attorney General	13	27	27	54	4
Human Services	15	37	18	55	4
Police & Emergency Services	8	16	8	24	3
Communities NSW	32	54	32	86	3
Health	53	70	101	171	3
Transportation	25	20	45	65	3
Education & Training	17	33	16	49	3
Industry & Investment	44	74	39	113	3
Environment, Climate Change & Water	43	50	55	105	2
Premier & Cabinet	16	16	16	32	2
Treasury	37	32	37	69	2
Services, Technology & Administration	14	16	5	21	1
Total	340	510	447	957	3

1 Represents the number of reporting entities in the cluster with 30 June year-ends.

2 Calculated as the total number of misstatements divided by the number of agencies in the cluster.

It should be noted in the above table that the average number of misstatements statistic can be distorted where there are a large number of non-operating entities and employment divisions with a low incidence of errors.

In dollar terms, the impact of the above-mentioned corrected and uncorrected misstatements on net assets and income is summarised in table below:

Cluster	Corrected misstatements		Uncorrected misstatement ¹		Total	
	Net assets	Income	Net assets	Income	Net assets	Income
	Increase / (decrease)	Increase / (decrease)	Increase / (decrease)	Increase / (decrease)	Increase / (decrease)	Increase / (decrease)
	\$m	\$m	\$m	\$m	\$m	\$m
Transportation	3,281.5	3,285.7	(174.6)	(217.1)	3,106.9	3,068.6
Treasury	122.6	147.5	1.9	(2.9)	124.5	144.6
Health	(198.4)	23.7	(41.1)	40.4	(239.5)	64.1
Planning	(27.9)	57.2	(43.4)	2.1	(71.3)	59.3
Communities NSW	57.1	49.1	(0.1)	(0.3)	57.0	48.8
Industry & Investment	(20.8)	(39.6)	2.3	3.1	(18.5)	(36.5)
Human Services	(12.2)	(18.0)	291.2	(1.8)	279.0	(19.8)
Education & Training	(11.5)	(10.9)	(2.5)	(5.8)	(14.0)	(16.7)
Police & Emergency Services	1.8	1.8	0.4	0.6	2.2	2.4
Premier & Cabinet	(0.4)	(1.5)	(0.1)	(0.1)	(0.5)	(1.6)
Services, Technology & Administration	1.6	1.6	(0.1)	(0.1)	1.5	1.5
Environment, Climate Change & Water	30.5	4.3	(8.1)	(4.6)	22.4	(0.3)
Justice & Attorney General	0.1	(4.2)	3.1	4.4	3.2	0.2
Total	3,224.0	3,496.7	28.9	(182.1)	3,252.9	3,314.6

1 Uncorrected misstatements were not corrected as they were immaterial to the financial statements.

Further details of the five largest misstatements are provided below:

Significant errors included:

Agency	Amount	Nature of error
Roads and Traffic Authority	\$4.3 billion ¹	Misstatement of earthwork assets ²
Roads and Traffic Authority	\$1.0 billion ¹	Spreadsheet error in roads valuation ³
Department of Health	\$188 million ¹	Misstatement in property, plant and equipment values
Crown Finance Entity	Commercial in confidence	Non-deferral and amortisation of components of NSW Lotteries transaction
Crown Finance Entity	\$147 million ¹	Misstatement in tax receivables

¹ Corrected in individual agency financial statements

² The misstatement of earthwork assets related to the determination of the balance of accumulated depreciation for these assets. The process of determining the fair value of earthwork assets is complex and requires significant judgment. The Roads and Traffic Authority took all reasonable steps to revise its accounting estimates well in advance of year end.

³ The misstatement identified represents less than 2% of the Authority's infrastructure asset base. The Roads and Traffic Authority advises that it will review all valuation models as part of the 2010-11 year end accounts preparation process.

Information Systems Audit

I completed information system related audit and review activities to support my financial statement audits. The key focus of these reviews is to assess agency General Computing Controls (GCC) whose primary purpose is the attestation of control effectiveness over data integrity, availability and security.

I also undertook Application Implementation reviews which are completed for selected high risk information technology projects. These two activities are described as follows:

GCC reviews address four areas:

GCC Audit Area	Description
Information Security	Verification of the controls that lead to the prevention or detection of unauthorised use of, and changes to, data, systems or programs including the establishment of system-based segregation of duties.
Data Centre and Network Operations	Verification of the controls over the integrity of information as it is processed, stored, or communicated by the relevant components of the Information Technology infrastructure.
Disaster Recovery Planning	Verification of the controls surrounding the establishment and testing of plans relating to disaster recovery (including back-up), protecting the capability of critical systems availability and recovery.
System Change Control	Verification of the controls over application systems, database management systems, network and communication software, systems software, and hardware – verifying that they have been effectively acquired, developed, implemented, and maintained.

Weaknesses in information security management and practices accounted for 61 per cent of the issues raised from my information system audits of the largest 60 agencies.

I noted that many agencies are migrating to new enterprise and financial systems, and this introduces financial and technology management risks. Accordingly, I have initiated Application Implementation Reviews to be completed for selected large projects. The purpose of these reviews is to assess key project governance and management activities, addressing the following four areas:

Application implementation review	Description
Project Governance	Review of mandate and activities of oversight bodies, review of risk management procedures and processes.
Project Management	Review of project methodology and plans and an assessment of change management, training, communication, testing procedures and stakeholder engagement.
Financial Management	Verification of financial accounting and reporting, as well as budget and expenditure tracking to deliverables.
IT Solution Management	Assessment of activity management within the resources and capabilities of the organisation.

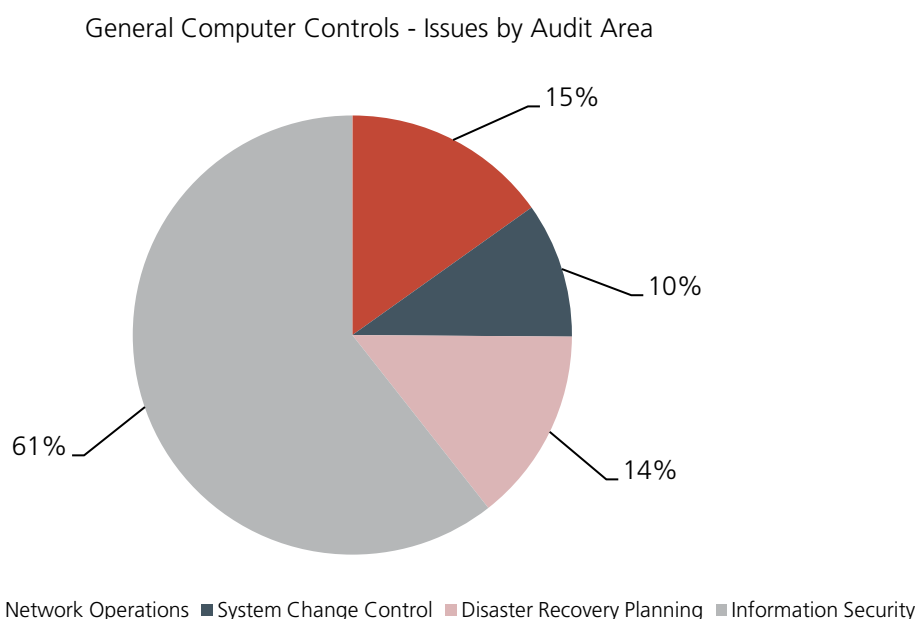
In late 2009, I undertook a review of the Information Technology (IT) landscape and developed a three year strategy that includes broadening the Audit Office's coverage of IT risk and to add value. Accordingly, my information system audit approach changed with a greater emphasis on IT technical skills and knowledge supported by automated security analyses and data mining tools.

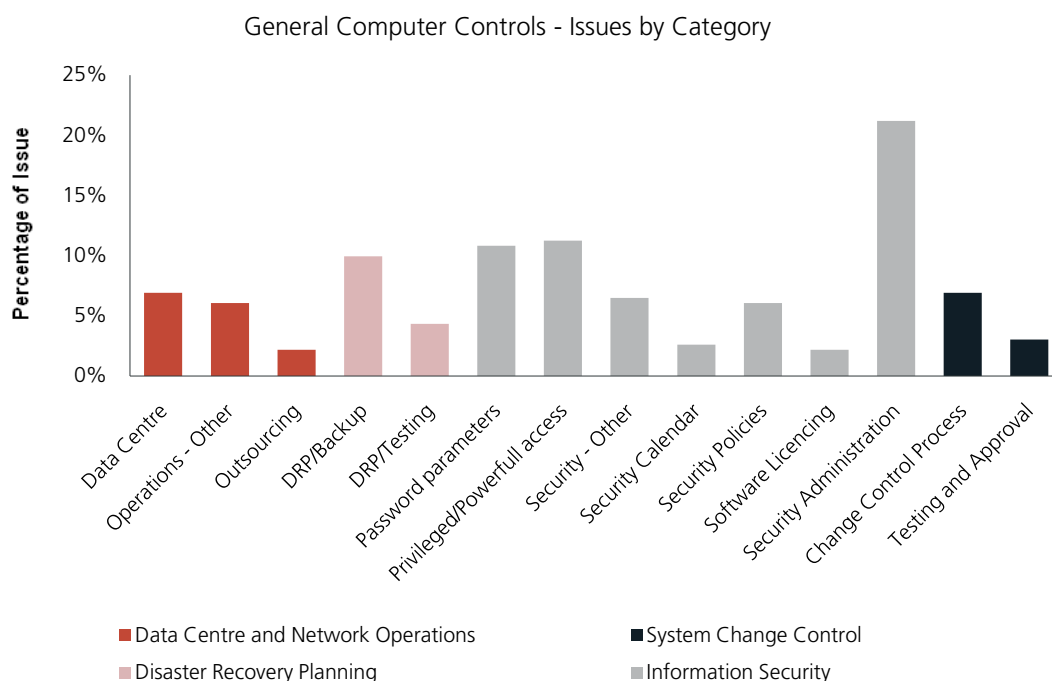
These activities resulted in:

- improved and augmented use of data mining and interrogation tools to examine and query both data and transactions
- an increased use of automated tools to assist with security assessments of IT environments supporting key financial systems
- tailored technical IT audit programs to specifically focus on application security and segregation of duties for critical financial application systems in particular, Enterprise Resource Planning (ERP) applications such as SAP, Oracle and PeopleSoft.

What Did I Find in 2010 – General Computing Controls

In reviews of the largest 70 agencies, I noted issues with respect to all four GCC areas as indicated in Figure 1. The majority of issues identified pertain to information security management and practices (61 per cent), data centre and network operations (15 per cent), disaster recovery planning (14 per cent), and system change control (10 per cent).





The following are 'examples' of the type of common weaknesses that were identified in a variety of agencies:

- security features that provide user accountability and enforce data security are not effectively used and configured. For example:
 - at one agency, 547 users (83 per cent) had never changed their passwords
 - at one agency, 71 per cent of user accounts had been inappropriately granted access to install their own software
- terminated contractors retaining access to the financial system
- network users with administrative access allowing the installation of unlicensed software. Further, there is no process to track unlicensed software
- external service providers with unrestricted access to privileged user accounts
- non-compliance with change control procedures allowing unauthorised users to make program changes
- no testing of the disaster recovery plans.

In large agencies, there are a myriad of business systems, complex networks and a large number of users. Managing information security in such environments is complex. In addition, there are many components that form a security environment and these components must be managed in a holistic manner to allow for good information security practices. As noted by many before me - information security is only as strong as the weakest link.

Many agencies use large Enterprise Resource Planning (ERP) applications such as SAP. I noted that a number of these agencies did not understand or identify security risk within the ERP and had not established an effective security framework including segregation of duties. As ERP security management is relatively new to most agencies, I recommend that the government establish guidelines, principles and training for all agencies that use ERP systems.

Software licencing is an area of risk. I noted that some agencies were not complying with licence agreements and many agencies did not have an effective process for proactively managing licence usage as agreed in software contracts. This issue places agencies at risk of severe fines by the software vendors. In fact, I did note one agency that paid a fine of almost \$500,000 for exceeding the use of approved licences.

Many agencies use external service providers to support day-to-day IT operations. These providers are often granted highly privileged access. While outsourcing can be an appropriate business strategy, there seems to be a view by some agencies that they can outsource both operational and reputational risk to the provider, and accordingly, do not monitor the provider's activities. I have highlighted to those agencies the need to monitor outsourced activities and the corresponding risk. However, some agencies still do not fully appreciate the resulting risks.

I also noted issues with respect to the management of disaster recovery planning. While many agencies have effective and tested recovery procedures and plans, there are also a number that are not adequately managing their risk of loss of information technology services. As a result, for some agencies there is a real risk of not being able to provide services should they lose some or all of their information technology resources.

My reports recommended that agencies should:

- establish minimum security standards, policies, and rules while recognising that individual agencies need to assess their own risk and may need to put in place a higher level of protection
- build awareness of the need to understand and manage information security and availability risk
- implement effective security administration processes
- implement a formal process to track software licenses and track unauthorised installations
- implement monitoring and review procedures so that all external service provider activities are effectively and appropriately managed
- develop and test disaster recovery plans.

What Did I Find in 2010 – Application Implementation Reviews

In 2010, I undertook two Application Implementation Reviews. In both cases I noted that project governance practices were implemented. These practices included oversight committees and the regular reporting of project progress, issues and cost monitoring. While these practices were appropriate for the projects, I noted that the governance committees were too far removed from the project and were not receiving complete and transparent information.

In one project, I noted poorly communicated risks and issues. Specifically, critical issues were not being raised and in fact, were being closed without following due process. As a result, the committees did not have a fair view of the project issues, risks and progress - placing the entire project at risk.

In any project there are three competing challenges, being - cost, time and quality. I noted that project management practices were implemented in line with industry standards to help manage all three challenges. However, while there were processes to comply with these standards, I noted that cost and time were often managed at the expense of quality.

I am particularly concerned with the lack of effective user engagement and feedback resulting in poorly designed and implemented processes. I also noted that there was a culture of blaming users by both the project and senior management. Project management and senior management must make every effort to ensure transparency and that users are respectfully engaged and assisted in the transition to ensure quality outcomes.

Landscape for 2011

Plans and efforts are being made by agencies to streamline systems and processes into common platforms which have led to a number of major initiatives and projects. Barring any changes to these IT strategies and initiatives, I will be adjusting our focus to identify their related potential risk exposures.

As a result, I plan to:

- develop strategies and tactics to address concerns regarding possible procurement frauds
- boost my capacity to identify agency officers who make deals with their own companies

Over half the Performance Audits recently conducted identified limitations in accountability, performance measurement and information quality.

- perform more detailed technical IT audits to identify risks and exposures associated with the core General Computer Control areas
- address the existence and appropriateness of automated controls within key financial applications to identify the extent of preventive controls, ensuring accuracy, validity and completeness of data
- carry out selected Application Implementation Reviews to ascertain and report the effectiveness of project management and control of application solutions prior to implementation.

Performance Audit Reports

Performance audits provide independent assurance to Parliament and the public that government activities are being undertaken efficiently, economically, effectively, and in accordance with the law. Through their recommendations, performance audits seek to improve the efficiency and effectiveness of government services.

Common Themes in Recent Performance Audits

In the 18-month period from 1 July 2009 to 31 December 2010, I published 23 performance audit and performance review reports.

These reports identify a number of common weaknesses in management arrangements for government programs. The table overleaf shows that over half the programs I examined had limitations in accountability, performance measurement and information quality. Some also showed a lack of interagency coordination and prevention, despite these being government priorities.

Lack of Transparency And Accountability

Accountability is a cornerstone of good governance and management arrangements. Clear accountability in roles and contracts supported by well documented and transparent decision making are key to accountable government. However, in nearly two thirds (14 out of 23) of the programs I examined I found weaknesses in transparency and accountability. This included lack of clear responsibilities, poor management oversight and reporting, or the absence of supporting information for the decisions made.

For example, the Electronic Information Security audit found that the Government is not able to provide assurance that it is safeguarding its holdings of sensitive personal information because its policy has not been properly implemented. I recommended strengthening the responsibility of CEOs to sign-off on security arrangements and to enforce strong action when security breaches occur. They should also be held to account through their performance agreements.

The absence of adequate supporting information is best illustrated in the NSW Lotteries Sale Transaction report, where there was no audit trail of supporting information retained for key recommendations of the Sale Transaction Review Committee. The absence of documentation conflicts with one of the principles outlined in the Probity Plan for the Sale which focused on transparency and accountability.

Poor Information

I also found poor quality of information hampered management in around half (12 out of 23) of the programs I examined. Quality includes completeness and accuracy of information to support decision making, but also extends to relevance, timeliness and accessibility.

In the Mental Health Workforce report, for example, I found it impossible to obtain accurate information on the size of the mental health workforce, or of recent increases, because data is inconsistent and in places inaccurate. This reduces NSW Health's capacity to plan its services and workforce effectively.

In my report on the Australian Museum, *Knowing the Collections*, the lack of a complete central database meant that management did not know the size, location, condition or value of its collections. This made it difficult to set priorities and strategies for managing and storing the collection and left it vulnerable to theft and deterioration.

Similar issues are likely in other museums and in departments with substantial (manual) record keeping.

Poor Performance Management

I found poor performance management occurred in nearly half (10 out of 23) of the activities audited in the last 18 months. Setting service delivery standards in contracts or service agreements, and monitoring performance against them, is becoming increasingly important as more and more of the delivery of government services is outsourced.

Too often, such service arrangements are set up without proper performance management in place. An example of this I found was reported in *Improving the Performance of Metropolitan Bus Services*. While I noted that service delivery, payments and budgets are closely monitored, four years after their contracts came into effect, a performance management regime is still being developed.

I identified similar weaknesses in monitoring performance in the Environmental Grants Administration and Electronic Information Security reports. And I can see continuing risks in this area with the expansion of shared service providers and Non Government Organisations in service provision to and for government.

Poor Coordination between Agencies

Government agencies often have to work together to implement Government policy in a consistent and equitable way. Five of the activities I examined in performance audits recently suffered from poor coordination of services. These occurred between government departments, and between them and the Non Government Sector.

For example, the *Administering Domestic Waterfront Tenancies* audit found operational differences between the two government departments involved that resulted in different rents and conditions for similar tenants. Fragmented and delayed reviews by the departments of practices had triggered criticism by tenants.

One of the government's aims with the 2009 amalgamations of departments into 'super agencies' (see earlier) is to improve coordination of services for such clients. I will continue to monitor the implementation of such changes in 2011, including those associated with the creation of new Local Health Networks and Clusters within NSW Health, as well as progress on the State Plan itself.

Limited Focus on Prevention and Early Intervention

Another emerging theme in my work over the last 18 months is the limited implementation of prevention and early intervention initiatives. This is despite the fact that a priority of the NSW State Plan (published in 2006, and revised in 2010) was to embed early intervention into the core workings of Government.

In the *Helping Aboriginal Defendants through MERIT* audit, for example, I found that, although MERIT is recognised as a highly appropriate intervention program for Aboriginal defendants, in 2007-08 it reached only 273 out of around 19,000 Aboriginal defendants who appeared before the court. Since 2006, despite its proven potential, MERIT has only been rolled out to one additional court. There are a number of very busy courts with a high proportion of Aboriginal defendants where MERIT is not available. Likewise, I found participation had declined in another program with potential to divert offenders from prison: *Home Detention*. This is despite four reviews of the program since 2004 recommending it be expanded.

Title	Transparency and accountability	Information quality	Performance management	Interagency coordination	Prevention and early intervention
Mental Health Workforce	✓	✓		✓	✓
Sick Leave	✓	✓			
Coal Mining Royalties	✓	✓	✓		
NSW Lotteries Sale Transaction	✓				
Electronic Information Security	✓		✓	✓	
Helicopter Emergency Medical Service Contract					
Pollution Incidents		✓	✓		
Home Detention		✓			✓
Knowing the Collections		✓			
Government Investment in V8 Races at Sydney Olympic Park	✓	✓		✓	
Severance Payments to Special Temporary Employees	✓				
Access to Overnight Centre-Based Disability Respite	✓	✓	✓	✓	✓
Injury Management	✓	✓	✓		
Improving the Performance of Metropolitan Bus Services			✓		
Road Safety in School Zones					
Working With Children Check	✓	✓	✓		
Managing Forensic Analysis: Fingerprints and DNA		✓	✓		
Government Advertising	✓				
Handback of the M4 Tollway	✓				
Government Licensing Project	✓				
Administering Domestic Waterfront Tenancies				✓	
Environmental Grants	✓	✓	✓		
Helping Aboriginal Defendants through MERIT			✓		✓
23 reports	14	12	10	5	4

Source: Auditor-General's Performance Audit and Performance Review Reports, Numbers 189 to 210.

The Wider Watch

I have maintained watching briefs on a wide range of government programs and initiatives in recent years to inform the selection of performance audits or other reviews. Some of these translated into reports published in the last 18 months, including Government Advertising, Government Investment in V8 Supercars, the NSW Lotteries Sale Transaction. Others will be published in 2011, including: Planning to Support the Barangaroo Development, Planning for the State's Solar Bonus Scheme and possibly, the Sale of Electricity Assets and the Sale of Waste Services.

Not all watching briefs end up as performance audit reports. Some are reported elsewhere in my Financial Audit Volumes (such as my work on the government's discontinued projects to build the Sydney Metro and the Tilleggra Dam, and on the 'Be Aware Take Care' government advertising campaign run by the WorkCover Authority of NSW).

Others do not proceed to any published report. These include a number where my initial examination has found no serious or substantial waste to justify further work. These include 27 protected disclosures containing a range of allegations covering mainly employment, contracting and purchasing matters.

My staff have proceeded no further on some potential performance audit topics because, after initial enquiries, I am satisfied that agencies are aware of these issues and have plans in place to address them. Examples include: Overcrowding in Juvenile Justice Centres and Performance of Taxi Services. It would be a waste of my limited resources to undertake a performance audit whilst such steps are in progress. I will keep these, and others like it, under watch in 2011, and consider undertaking further work if no improvements result.

Electricity Sale Transactions

On 14 December 2010, the Government sold its electricity retail businesses, part of its electricity generation output and some development sites to Origin Energy and TRUenergy.

The following analysis of the electricity sale transactions has been performed to gain an understanding of the transactions and possible impact on the financial statements of the individual electricity agencies and the State for the year ending 30 June 2011.

The accounting treatment is yet to be finalised and I intend to comment on this in more detail on completion of my financial audit. I am also considering conducting a performance audit on other aspects of the transactions at a later date.

Summary of Transactions

The following tables summarise details of the consideration receivable for the sale transactions entered into on 14 December 2010.

The amounts payable at commencement date (27 February 2011 and 1 March 2011) for the electricity output of the Eraring and Delta West bundles are:

Vendor	Purchaser	Gross proceeds \$ million
Eraring Energy	Origin Energy	950 [#]
Delta Electricity	TRUenergy	539 [^]
Total		1,489

[#] Final amounts to be assessed at commencement date for fuel/coal stock, hedge book, coal supply and ancillary services where applicable.

[^] Final amounts to be assessed at commencement date for fuel/coal stock.

The consideration payable to Vendors for each retail business sold are:

Vendor	Purchaser	Gross proceeds \$ million
Country Energy	Origin Energy	1,300
EnergyAustralia	TRUenergy	1,480
Integral Energy	Origin Energy	1,000
Total		3,780*

* Excludes any purchase price adjustments relating to unbilled income and working capital.

The consideration payable at the commencement date for the development sites are:

Development site	Vendor	Purchaser	Gross proceeds \$ million
Marulan	EnergyAustralia	TRUenergy	6.4
Marulan	Delta Electricity	TRUenergy	8.6
Mount Piper Extension [#]	Delta Electricity	TRUenergy	1.0
Total			16.0

[#] See page 58 regarding remediation costs.

The above proceeds include the stamp duty payable by the purchasers.

Treasury has advised that approximately \$1.25 billion of the proceeds of the transactions will be used to retire Eraring's existing debt and a portion of Delta Electricity's existing debt. I understand Eraring's existing debt is \$800 million and that \$450 million would be applied to Delta Electricity's debt.

Main Elements of the Transactions – Generation Trading (GenTrader) Agreements

The significant rights and obligations of the Agreements are outlined in the table below. Origin Energy and TRUenergy are referred to in the Agreements as GenTraders, while Delta Electricity and Eraring Energy (State owned corporations) are referred to as the Owners.

Rights and Obligations

GenTraders	Owners
<i>Rights</i>	<i>Rights</i>
Owns 100 per cent of electricity output of the power stations	Retains ownership of the power stations
Entitled to revenue resulting from trading electricity in the National Electricity Market	Retains all employees
Controls the dispatch of electricity from the power station	Entitled to payments in the form of capacity charges from the Crown.
	Entitled to fixed, variable and pass-through charges from the GenTraders
Entitled to liquidated damages (up to a cap) if contracted availability performance standards are not met	Entitled to compensation for excess dispatch of electricity caused by the GenTrader
Assumes existing hedge book	
<i>Obligations</i>	<i>Obligations</i>
Schedule the output of the power stations at or above the minimum generation levels	Operate and maintain the power stations (including associated capital works) to make power stations available to meet contracted supply
Purchase and supply coal to the power stations	Supply 100 per cent of electricity output to the GenTraders
Pay Capacity Charges for the generation rights	Manage coal from receipt to burn
Pay fixed, variable and pass-through charges to cover the estimated costs of operating and maintaining (including associated capital expenditure) the power stations	Maintain connection to the transmission network
Responsible for the cost of capital improvements initiated by the GenTraders and change events	Pay liquidated damages (up to a cap) if availability targets are not met due to specific identified measures
Bear the cost of auxiliary power requirements (cost of electricity used in running power stations) up to a set limit	Variability in capital, maintenance and operating costs are the responsibility of the Owners
Liable for carbon costs and entitled to carbon benefits	Pay Over Generation Charges, if this occurs
Maintain insurances including those safeguarding interests of the Owners	Make available existing water rights of the power station
Water supply risk	Manage spare parts for use at the power stations

Sale of Electricity Output

Capacity Charges – these are paid by the GenTraders to the Owners in consideration for all the electricity output of the power stations. These charges are levied in accordance with a predetermined schedule over the term of the Agreement, which is the estimated remaining useful life of the power station.

The agreement provides for the capacity charges to be paid upfront by the GenTrader and held by the Crown as a security deposit. The Crown will pay interest to the GenTrader at a rate of 5.2 per cent per annum which will be added to the initial deposit. The prepaid amount and accrued interest is not immediately available to the Owner. It is released annually by the Crown to the Owner in accordance with the Capacity Charges Schedule.

The deposit deeds allow the Crown to pay the capacity charges to the Owners by a method other than a cash payment.

The amounts to be paid at the commencement date for the Eraring and Delta West bundles are detailed below:

	Eraring bundle \$'000	Delta West bundle \$'000
GenTrader Transaction Agreement Payment for Power Stations:		
Eraring	856,000	--
Shoalhaven	11,080	--
Mount Piper	--	452,800
Wallerawang	--	1,000
	867,080	453,800
Fuel Stock Initial Payment	61,000 ^a	85,000 ^a
Hedge Book / Ancillary Services / Coal Supply amounts	21,170 ^a	--
Transition Costs (Costs to transition key processes and information from the Owner to the GenTrader)	750 ^b	200 ^b
Total	950,000	539,000
Contingent payment on obtaining tax ruling	198,000	60,000

a Estimated / final amount to be assessed after completion

b Amount to be updated at completion based on Final Transition Plan.

Operation and Maintenance of the Power Station

The Owner is able to recoup the costs of operating and maintaining the power station through a range of charges to the GenTrader. These include:

- **Fixed Charges** - these charges are based on the estimated costs of operating (including salaries and wages) and maintaining the power station and include associated capital expenditure. The scheduled annual charges are fixed and paid monthly over the term of the agreement. Any variations up or down between the actual operating and maintenance costs and the annual fixed charge recouped from the GenTrader are the cost or benefit of the Owner. Fixed charges are escalated quarterly by a factor derived from the Wage Price, Producer Price and Consumer Price indices
- **Variable Charges** - these charges recoup the cost of consumables related to the power station. They are paid at a set rate (escalated quarterly by the indexation factor) per MWh for the electricity sent out during each month
- **Pass Through Charges** - these charges recoup costs for water, transmission connection, licence fees, rates and land taxes.

Available Capacity and Liquidated Damages

The GenTrader Agreements include monthly targets for contracted availability for all generating units at each power station. Separate targets are calculated for peak, off peak, weekend and super peak periods.

Availability targets for Mt Piper power station range from 92.32 per cent (off peak) to 96.99 per cent (for both peak and super peak) while Eraring ranges from 91 per cent (off peak) to 96.15 per cent (peak and super peak). These targets are the same for the first five years of the agreements and then begin to decrease annually.

Where targets are not achieved, the Owners are required to pay liquidated damages to the GenTraders. These amounts are calculated for each half hour period and are subject to a total annual cap.

Treasury has advised the General Purpose Standing Committee No. 1 that:

Treasury have calculated what we believe to be the net present values of the expected risk associated with ALDs over the life of the GenTrader contracts. We determined that to be roughly \$360 million in net present value terms.

Over Generation Charge

The Owner must pay the GenTrader an Over Generation Charge when more electricity is generated than instructed by the GenTrader. This charge is payable when the amount of electricity generated exceeds the instruction by more than 5 MWh.

Liability Cap for Availability Liquidated Damages and Over Generation Charges

The first contract year of the agreements is limited to a four month period to 30 June 2011 and liabilities for Mt Piper and Eraring power stations are capped at \$53.1 million and \$31.0 million respectively. The cap for Eraring increases to \$93.5 million in year two, reflecting a full twelve month period however, for Mt. Piper it reduces to \$49.7 million. Each cap then decreases annually over the remaining term of the agreements. The total cap ranges from \$144.6 million in year 2 to \$53.7 million in year 22.

Coal

The GenTraders are responsible for the supply of all coal burnt in the power stations. At the commencement of the GenTrader Agreements, the GenTraders will pay the Owners the value of coal at each site. Coal supplied under current contracts will be 'on-sold' to the GenTraders and they will be responsible for supplying and paying for all further coal requirements.

The Owners will receive coal from the GenTraders and will be responsible for managing the coal until it is burnt in the power stations. Owner responsibilities include weighing and sampling the coal on receipt and reclaiming, weighing, sampling, conveying and handling the coal from the stockpiles to the coal mills of the power stations. Despite these Owner responsibilities, all other risk in coal, until it is burnt in the power stations, remains with the GenTraders at all times and does not pass to the Owners.

Cobbora Coal Mine Development

As I previously reported, I understand the preferred tenderer to build and operate the coal mine submitted an offer that the Government did not accept. Now a Government entity (Miner) will develop the coal mine near Cobbora and supply coal to the GenTraders for a period of 17 years from 1 July 2015. The miner will also supply coal to Macquarie Generation and Delta Electricity Coastal.

The coal will be made available to the GenTraders at a price based on the estimated cost of production. The base price is \$1.47/GJ (\$31.16 per tonne) and is adjusted for the ash, moisture and sulphur content of the coal. The coal will be supplied for the term of the contract with the Miner and the coal price is subject to quarterly indexation.

Coal quantities supplied to the GenTraders are fixed over the contract term but may be varied by notification to the Miner prior to 16 May 2011. GenTraders are responsible for arranging the haulage of coal from the mine to the power stations and to pay State mining royalties.

A government entity (Rail Developer) will develop a rail spur, which will connect the mine to the existing rail network. The Rail Developer will grant access to the rail spur to the GenTraders and charge the GenTraders an access fee, which will be indexed quarterly.

Terms of the Agreement

The terms of the GenTrader Agreements are detailed below.

Term of the Agreement	Commencement Date	Expiry	Period *
Eraring Bundle			
Eraring Energy	27 February 2011	30 June 2032	22 years
Shoalhaven	27 February 2011	30 June 2038	28 years
Delta West Bundle			
Mt Piper	1 March 2011	30 June 2043	33 years
Wallerawang	1 March 2011	30 June 2029	19 years

* estimated remaining useful life of the power station.

Risks and Uncertainties

The table below highlights the significant risks and uncertainties for the Owners arising from the Agreements.

Uncertainties / Risks of owners

Availability Liquidated Damages	Where contracted availability targets are not achieved, the Owners must pay liquidated damages to the GenTraders. Except for a super peak bonus paid to Eraring Energy, the Agreements do not provide for bonuses where targets are exceeded The annual amount of the liquidated damages is capped
Coal	The costs of remedial action to manage clinkering (the removal of incombustible residue arising from the burning of coal) is the responsibility of the Owners
Fixed Operating (including salaries and wages), Maintenance and Capital Costs	The variability between the costs of operating and maintaining the power stations and the fixed charges, variable charges and pass-through charges included in the GenTrader Agreements are the responsibility of the Owners The risks associated with timing mismatches between fixed cash inflows from the GenTraders and variable cash outflows by Owners are the responsibility of the Owners
Power Stations – Remediation of Sites	The GenTrader Agreements do not provide for the costs of shutting down the power stations at the end of their lives and possible remediation of the sites
Generation of Excess Electricity	The Owners must pay the GenTraders Over Generation Charges when more electricity is generated than instructed by the GenTraders. These charges are payable when electricity generated exceeds GenTrader's instructions by more than 5 MWh
Auxiliary Power Supply	If the Owners exceed annual limits for the use of auxiliary power (electricity used in running the power station) they will pay excess auxiliary power charges to the GenTraders
Cobbora Coal supply in respect of Eraring Energy	If the Miner is unable to deliver the contracted quantity of coal and the GenTrader obtains an alternative supply at a higher cost, the Miner will pay the GenTrader a 'shortfall payment'
Development Sites	Agreements do not require the GenTraders to develop sites within specified timeframes Mt Piper site – the site encompasses a rehabilitated open cut mine area and the Owner is liable for unlimited remediation costs (which have not been estimated) prior to development

Accounting Implications

Until the sales transactions are completed, their consequences on the accounting treatment cannot be finalised. The consequences could be significant, for example at 30 June 2010 the value of the four power stations included in the GenTrader contracts was \$3.0 billion. This value may need to be substantially reduced due to lower future levels of net income.

Treasury has advised the General Purpose Standing Committee No. 1 that:

The design of the GenTrader agreement is such that Eraring's costs broadly will be covered by the fixed and variable operating payments that it gets from the GenTrader. So rather than being the trading profit-making enterprise that it is today, it is effectively getting coverage of its costs from the GenTrader.

In addition, it is not known at this stage what effect the sales transactions will have on the Owners' profitability and whether the Owners will be able to maintain solvency without financial support from the Government. I understand the Owners have been given written financial support guarantees from Government to ensure solvency.

Main Elements of the Transactions – Retail Sale and Purchase Agreements

The significant rights and obligations, and associated risks of the retail Sale and Purchase Agreements (SPAs) and Transition Services Agreements (TSAs) are outlined in the tables below. Origin Energy and TRUenergy are referred to in the agreements as the Purchasers, while EnergyAustralia, Integral Energy and Country Energy (State owned corporations) are referred to as the Vendors.

Rights and Obligations

Purchasers	Vendors
<i>Rights</i>	<i>Rights</i>
Entitled to existing customer contracts and brand names	Entitled to receive the purchase consideration.
Entitled to deduct performance rebates if the Vendors fail to provide services in accordance with agreed service levels	Entitled to receive Service Charges for the duration of the TSA.
<i>Obligations</i>	<i>Obligations</i>
Operate the retail businesses following completion of the TSAs	Provide certain retail services in accordance with the TSAs:
Pay charges to the Vendors for services provided in accordance with the TSA	<ul style="list-style-type: none"> provide services such as billing, collections and debtor management provide customer services, including call centres and business information services.
Transferring award/enterprise employees are entitled to a five year employment guarantee of conditions and rate of pay	<p>Pay transfer payments to Vendor employees who choose to take up offers of employment from the Purchasers.</p> <p>Non-transferring Vendor employees are entitled to a five year employment guarantee.</p> <p>Rebrand the remaining businesses</p>

Terms of the Agreement

The table below shows the consideration payable to the Vendors for each retail business sold.

Vendor	Purchaser	Gross proceeds* \$ million
Country Energy	Origin Energy	1,300
EnergyAustralia	TRUenergy	1,480
Integral Energy	Origin Energy	1,000

* Excludes any purchase price adjustments relating to unbilled income and working capital.

The key dates and activities included in the SPA are summarised in the following table. Except where stated, the scheduled dates are the same for all three sale agreements.

Event	Date
SPA Signed	14 December 2010
Scheduled Completion Date	1 March 2011 This is the scheduled date on which the Vendors deliver title of the assets sold (i.e. the retail business) to the Purchasers
Final Completion Statement	Issued within 20 business days for EnergyAustralia and 40 business days for Integral Energy and Country Energy of an independent auditor providing a review opinion and working papers to both parties The Completion Statement is a statement of working capital prepared as at 11:59pm on the day before the Completion Date. The Final Completion Statement is used to determine the final Working Capital Adjustment Payment and is due no later than five months after legal day one
Working Capital Adjustment Payment	10 days after the Final Completion Statement is agreed
Warranty Period for Claims	12 months after the Completion Date for EnergyAustralia 18 months after the Completion Date for Country Energy and Integral Energy
Warranty Caps	Claims are limited to a total cap equal to 20 per cent of the Purchase Price (except for title claims where the cap is 100 per cent)
Purchaser Re-sale Restriction Period	Purchasers cannot resell the businesses within 24 months from the completion date for the first energy reform transaction, and 12 months from the completion date for the final energy reform transaction

Risks and Uncertainties

The table below highlights the significant risks and uncertainties for the Vendors arising from the agreements.

Stranded costs	Purchasers are under no obligation to offer employment to Vendor employees. The Vendor may be required to provide for redundancy and separation costs of excess employees
Credit ratings	Levels of gearing may impact Vendors' credit ratings, increasing the costs of borrowing
TSA fees	Variability between fees and actual costs are the responsibility of the Vendors

Contracts do not require the Purchaser of the development site formerly held by EnergyAustralia to develop the site within a specified timeframe.

The three State owned energy retailers entered into SPAs on 14 December 2010 to sell their retail business activities to Origin Energy and TRUenergy.

The retail business activities sold include retail business contracts, gas inventory (where the retailer previously conducted a gas supply activity), surplus green rights, former customer debtors, retail business intellectual property, retail business materials and goodwill.

The Government will retain ownership of the network business comprising the electricity transmission and distribution network (poles and wires) and metering functions.

Once the transaction documents are effective, Vendors will cease carrying on retail businesses and energy supply activities to the retail and wholesale energy markets, other than services provided under the TSAs.

Up to the date of completion, each retailer must conduct the retail business in substantially the same manner taking all reasonable steps to preserve the retail business.

Transition Services Agreements

After completion, Vendors will continue to provide certain retail business services under the TSAs for up to 25 months for Integral Energy, up to 36 months for EnergyAustralia, and up to 43 months for Country Energy.

Retail employees are not required to transfer to the Purchasers. However, Origin Energy and TRUenergy may offer them employment.

The final purchase considerations are subject to working capital adjustments.

In addition, the Purchasers are also responsible for assuming Vendor liabilities relating to transferred retail contracts, market arrangements and pre-completion market obligations. Purchasers must also perform certain obligations relating to transferring employees (including employee entitlements and superannuation), closing out futures positions and entering into various ancillary agreements.

The completion is expected on 1 March 2011, however completion can be extended in certain circumstances. If completion of the SPA does not occur by 1 September 2011 the Vendors or Purchasers may terminate the SPAs, if they are not in default.

Electricity Reform Overview

For many years the New South Wales Government has owned and operated seven State owned corporations involved in producing, transmitting, distributing and selling electricity. Macquarie Generation, Delta Electricity and Eraring Energy are responsible for generating electricity, TransGrid is responsible for transmitting it, while EnergyAustralia, Integral Energy and Country Energy, are responsible for distributing and retailing it.

The Government first proposed selling the power stations, poles and wires and retail businesses in 1997. However, it has never proposed selling the high voltage transmission network.

In 2007, the Government commissioned Professor Anthony Owen to determine the State's power needs. The Owen Report concluded that additional investment would be needed in base load power plant from 2013-14 to meet demand and recommended the Government 'divests itself of all State ownership in both retail and generation'. Following the Report, the Government announced in December 2007 its intention to withdraw from the retail electricity market and lease the operations of the power stations to the private sector. Under the Government's strategy, the poles and wires for transmitting and distributing electricity would remain under Government control and operation.

The Government's 2007 strategy intended to significantly increase private sector investment in new electricity generation capacity for New South Wales and to increase competition in the New South Wales electricity market.

In 2009, the Government announced its latest policy position on the restructure of the New South Wales electricity industry when it released the 'New South Wales Energy Reform Strategy: Approach to transaction implementation' (the Strategy) and outlined the framework for the restructure, which comprised the following key elements:

- continued Government ownership and operation of existing power stations and all electricity networks (poles and wires) in New South Wales
- contracting the electricity trading rights of power stations to the private sector, commonly referred to as the 'GenTrader' model
- selling the retail arms of EnergyAustralia, Integral Energy and Country Energy
- selling key power station development sites around the State.

As I previously reported, implementing the Strategy faced a number of challenges, including:

- trade-offs between maximising the financial return to the Government and minimising potential ongoing Government liabilities
- the impact and uncertainty of any future carbon reduction scheme that may discount the value Government will achieve
- the complexity of the GenTrader model
- the residual risks that may remain with Government when implementing any agreements.

In 2010, the Government commenced its energy reform process proposing:

- the sale of the retail businesses and brand names of EnergyAustralia, Integral Energy and Country Energy
- the sale of the electrical output of the existing State owned generators in the following four GenTrader Bundles:
 - Eraring Bundle, comprising the Eraring (2,690MW) and Shoalhaven (240MW) power stations
 - Delta West Bundle, comprising the Mt Piper (1,400MW) and Wallerawang (1,000MW) power stations
 - Delta Coastal Bundle, comprising the Vales Point (1,320MW), Colongra (667MW) and Munmorah (600MW) power stations
 - Macquarie Generation Bundle, comprising the Bayswater (2,640MW) and Liddell (2,000MW) power stations
- the sale of seven power station development sites currently owned by the State owned energy businesses.

Sale of Electricity Generation Output, Development Sites and Retail Businesses

In May 2010, the Government announced it had received expressions of interest from 'qualified and capable domestic and international bidders'. The sale process commenced in July, bids closed on 15 November, and on 14 December the Government announced the initial outcomes of the reform process:

- the sale of the retail businesses of Integral Energy, Country Energy and the Eraring GenTrader bundle (comprising the Eraring and Shoalhaven power stations) to Origin Energy for combined gross proceeds of \$3.25 billion
- the sale of the retail business of EnergyAustralia and the Delta West GenTrader bundle (comprising the Mt Piper and Wallerawang power stations), the Mt Piper development site and two development sites at Marulan to TRUenergy for combined gross proceeds of \$2.035 billion.

On 13 December 2010, the Special Minister of State and Portfolio Minister for Eraring Energy and Delta Electricity requested the Directors of Eraring Energy and Delta Electricity to enter into the GenTrader transaction and execute transaction documents. The request had the approval of the voting shareholders (Treasurer and Minister for Finance) under sections 20X and 20Y of the *State Owned Corporations Act 1989* (SOC Act). A similar request was made to the Directors of the three electricity retail businesses. Several Directors from Eraring Energy and Delta Electricity resigned and new Directors were appointed before considering the transaction documents.

After considering the transaction documents, the Boards of Eraring Energy, Delta Electricity, Country Energy, EnergyAustralia and Integral Energy determined that it was not in the commercial interests of their entity to comply with the request.

Sub-section 20N(1) of the SOC Act provides that:

If the Portfolio Minister wishes a statutory SOC to perform activities or to cease to perform activities, or not to perform activities, in circumstances where the board considers that it is not in the commercial interests of the SOC to do so, the Minister with the approval of the Treasurer may, by written notice to the board, direct the SOC to do so in accordance with any requirements set out or referred to in the notice.

On 14 December 2010, the Special Minister of State issued a Direction under section 20N(1) to the Directors of Eraring Energy and Delta Electricity to, among other things, enter into the GenTrader Agreements. A Direction was also given to the Directors of the three retail businesses to enter into the Sale and Purchase Agreements.

Sub-section 20N(2) requires the Boards to comply with a Direction. The Boards resolved to comply with the Direction on 14 December 2010.

Sub-section 20N(3) entitles a State owned corporation to be reimbursed for the net cost of complying with a direction.

Sub-section 20N(4) provides that the amounts and times of payment of these reimbursements are to be agreed by the Treasurer and the State owned corporation or failing an agreement, by a suitably qualified person or persons nominated by the Premier.

The Boards of the State owned corporations have advised that the respective transactions were not in the commercial interests of their entity. I understand that some of the retail entities and generator entities are currently pursuing with the Treasurer the amount of reimbursement required.

The Government signed GenTrader Transaction Implementation Deeds with the State owned corporations and Origin Energy and TRUenergy on 14 December 2010. The Deeds set out certain transaction documents to be entered into by the Owners and Origin Energy and TRUenergy and arrangements for completion of associated transactions. The completion date for these transactions under the Deeds is nominated as 1 March 2011, however completion can be extended in certain circumstances. If completion does not occur by 1 September 2011 termination provisions are available to both parties.

The Premier announced on 1 February 2011 that the Government would not proceed with any further privatisation of the State's electricity supply. No bids were received for the remaining bundles comprising Macquarie Generation (Bayswater and Liddell power stations) and Delta Coastal (Vales Point, Munmorah and Colongra power stations), and three development sites (Tomago, Munmorah rehabilitation and Bayswater B).

I understand that the sale of the Bamarang development site is in an advanced stage of negotiation.

Net Expected Proceeds

Treasury has advised the General Purpose Standing Committee No. 1 that in accordance with the recommendation in my 2008 report to Parliament, it has calculated a confidential retention value for each generator and each retailer. These retention values are commercial-in-confidence. However, Treasury has advised the Standing Committee that the gross proceeds of the sale, less the estimated future liabilities, exceed the retention values.

In order to finalise my financial audits later this year I will need the following information:

Eraring:	\$ million
Gross Proceeds	
Less: Estimated future liabilities	
Availability Liquidated Damages	
Excess of Operating and Maintenance costs above prescribed amounts to be paid by GenTrader	
Transition Costs	
Shortfall of Coal	
Other Liabilities	
Total Liabilities	
Net Expected Proceeds	
<hr/>	
Delta West (including development sites):	\$ million
Gross Proceeds	
Less: Estimated future liabilities	
Availability Liquidated Damages	
Excess of Operating and Maintenance costs above prescribed amounts to be paid by GenTrader	
Transition Costs	
Remediation of sites	
Other Liabilities	
Total Liabilities	
Net Expected Proceeds	

Country Energy:	\$ million
Gross Proceeds	
Less: Stamp duty	
Estimated future liabilities	
Working capital	
Adviser transaction costs	
Transition costs (including rebranding, IT and project management)	
Employee guarantees and redundancies	
Overhead redistribution	
TSA cost not reimbursed	
Stranded assets	
Other Liabilities	
Total Liabilities	
Net Expected Proceeds	
<hr/>	
EnergyAustralia (including development sites):	\$ million
Gross Proceeds	
Less: Stamp duty	
Estimated future liabilities	
Working capital	
Adviser transaction costs	
Transition costs (including rebranding, IT and project management)	
Employee guarantees and redundancies	
Overhead redistribution	
TSA cost not reimbursed	
Stranded assets	
Other Liabilities	
Total Liabilities	
Net Expected Proceeds	

Integral Energy:	\$ million
Gross Proceeds	
Less: Stamp duty	
Estimated future liabilities	
Working capital	
Adviser transaction costs	
Transition costs (including rebranding, IT and project management)	
Employee guarantees and redundancies	
Overhead redistribution	
TSA cost not reimbursed	
Stranded assets	
Other Liabilities	
Total Liabilities	
Net Expected Proceeds	

Treasury has provided me with 'groupings' of its estimated future liabilities figures but not the itemised estimated future liabilities for each of the five entities.

Treasury has advised that the total offsets used in their calculations are:

	\$ million
Ancillary (stranded) costs – Country Energy/Integral Energy	46-92
Potential ALDs – Eraring Energy	119
Ancillary (stranded) costs – Energy Australia	96-122
Potential ALDs – Delta West	234
Transaction costs (advisors)	200
Total	695-767

Treasury has indicated that it will provide the complete figures for the above tables as a matter of priority.

The response to this Report from Treasury follows.



The Treasury

Mr Peter Achterstraat
Auditor-General
The Audit Office of New South Wales
GPO Box 12
SYDNEY NSW 2001

Contact: Richard Timbs
Telephone: (02) 9228 3340

16 FEB 2011

Peter
Dear Mr Achterstraat

Report on Electricity Sale Transactions

Thank you for the opportunity to review and comment on your Electricity Sale Transactions report ("Report").

The comments in this letter reflect the thoughts and views of members of the Energy Reform Transaction team, Treasury officials and key external advisors to the State on the Transaction.

The following over-arching comments on the Report are made:

- o The Report focuses on the risk profile of the State and its relevant businesses in the post-transaction environment but does not establish a relevant counterfactual, by examining or explaining the position of the State and its relevant businesses pre-Transaction. This potentially creates a misleading and unbalanced view of the Transactions by establishing an inference that the State has acquired new risks, where in fact many of these risks existed both pre-and-post transaction.
- o In attempting to summarise key aspects of the Transaction, the Report omits important detail, the absence of which produces a distorted view of the Transaction (refer point below on Available Capacity and Liquidated Damages). For completeness and balance certain amendments and additions to the Report were suggested but were not included in the final Report.

Some further comments are detailed below.

Sale of Electricity Output

The Report states that the upfront payments are not immediately available to the Owner (ie the Generators) but does not confirm that the upfront payments are immediately available to the Crown as has been confirmed by the State's legal advisors and advised to the Audit Office by Treasury in correspondence.

Available Capacity and Liquidated Damages

The Report does not sufficiently explain the way in which Availability targets are calculated and measured.

Cobbora Coal Mine Development

The Report discloses commercial-in-confidence information about Cobbora coal pricing against the advice of Treasury and the State's advisors. Having disclosed some information the Report does not disclose all pricing information and so produces a distorted and therefore misleading view about Cobbora coal pricing.

Bamarang

A contract for the sale of the Bamarang development site was signed by Delta Electricity on February 11, 2011.

Net Expected Proceeds

As discussed the Net Expected Proceeds table will be completed and forwarded to the Audit Office as a matter of priority.

Treasury is happy to continue to provide the Audit Office with access to Treasury officials and/or members of the transaction advisory team should the Audit Office require further information or background in order to better understand the post-transaction environment.

Yours sincerely



Michael Schur
Secretary

Waste Recycling and Processing Corporation (WSN Environmental Solutions)

Audit Opinion

The audit of the Corporation's financial statements for the year ended 30 June 2010 resulted in an unqualified Independent Auditor's Report. However, the Independent Auditor's Report drew attention to significant uncertainties as to whether:

- a provision for net costs associated with a major contract is necessary. The Corporation determined that no provision was required
- the extent of impairment of a cash generating unit is appropriate.

Key Issues

Sale

Following the announcement in December 2010, the Government sold part of WSN to the private sector for \$235 million on 31 January 2011. The assets sold to the private sector include:

- two engineered landfills (Lucas Heights and Eastern Creek)
- two advanced Resource Recovery ventures (Narellan and Eastern Creek)
- eight transfer stations
- three material recovery facilities
- a 101 truck waste and recycling collection business.

Waste Assets Management Corporation

The government has established an agency, Waste Assets Management Corporation, to manage landfill sites not sold. It has committed to set aside a portion of the sale proceeds for settling landfill liabilities relating to rehabilitation and maintenance.

Impairment of Assets

At 30 June 2010, the Corporation assessed the fair value of a cash generating unit and recognised an impairment of \$17.2 million. The assessment included a wide range of judgments, assumptions and estimates. Because of this, there is significant uncertainty as to whether the extent of impairment is appropriate.

Efficiency of the Performance of the Corporation

The *Waste Recycling and Processing Corporation Act 2001* requires the Corporation to operate at least as efficiently as any comparable businesses. The Corporation's view is that there are no similar comparable businesses operating in the same environment. In the absence of comparable businesses the Corporation has been unable to perform efficiency assessments since its inception.

Following the announcement in December 2010, the Government sold part of WSN to the private sector for \$235 million on 31 January 2011.

The government has established an agency, Waste Assets Management Corporation to manage landfill sites not sold. It has committed to set aside a portion of the sale proceeds for settling landfill liabilities relating to rehabilitation and maintenance.

Performance Information

The Corporation provided the following information regarding its trade performance:

Trade Volumes

Year ended 30 June	Target		Actual			
	2010	2010	2009	2008	2007	2006
Total waste received ('000 tonnes)	na	1,802	1,990	1,967	1,846	1,928
Total waste sent to landfill ('000 tonnes)	na	1,362	1,571	1,616	1,559	1,528

Source: Waste Recycling and Processing Corporation (unaudited).

na not available.

The Corporation explained that the volume decreases for the year was due to market conditions.

Financial Performance

Year ended 30 June	Target*		Actual			
	2010	2010	2009	2008	2007	2006
Earnings/(losses) before interest and tax (\$m)	15.9	(10.1)	16.0	29.9	19.3	16.2
Return on average equity (%)	3.8	(6.5)	4.0	10.5	6.5	7.3
Return on average assets (%)	3.7	(2.7)	4.2	8.1	5.9	5.8
Interest cover (times)	na	(1.0)	2.5	8.4	3.1	10.7
Debt to equity ratio (%)	na	51.6	31.8	17.9	-	35.9
Dividend paid to Government (\$m)	3.2	--	6.8	4.8	5.3	5.4

Source: Waste Recycling and Processing Corporation (unaudited).

* Target agreed with shareholder Ministers in the Statement of Corporate Intent.

na not available.

The Corporation did not meet its targets largely due to an impairment expense of \$17.2 million on plant and equipment.

Financial Information

Abridged Statement of Comprehensive Income

Year ended 30 June	2010 \$'000	2009 \$'000
Waste processing revenue	273,281	270,569
Other	7,803	9,727
Total Revenue	281,084	280,296
Employee benefits expense	57,568	52,321
Depreciation and amortisation	22,411	22,441
Government waste levy	68,751	60,785
Impairment on plant and equipment	17,243	--
Contract and other expense	135,102	135,227
Total Expenses	301,075	270,774
(Loss) / Profit Before Tax	(19,991)	9,522
Income tax equivalent benefit/(expense)	8,674	(1,810)
(Loss) / Profit After Tax	(11,317)	7,712
Other Comprehensive Income / Expense		
Loss on revaluation of properties	(15,138)	--
Fair value adjustment on foreign exchange contracts	(1)	117
Superannuation actuarial losses	(425)	(2,756)
Income tax expense on items of other comprehensive income	4,669	827
Total Other Comprehensive Income/(Expense)	(10,895)	(1,812)
Total Comprehensive (Expense)/Income	(22,212)	5,900

The increase in employee benefits expense of \$5.2 million was mainly due to award rate increases and a marginal rise in the number of employees.

The rise in the government levy rate for the year contributed to the \$8.0 million increase in waste levy expense.

The loss on revaluation of properties reflects the decrease in fair market values of the Corporation's land assets.

Abridged Statement of Financial Position

At 30 June	2010 \$'000	2009 \$'000
Current assets	59,871	43,949
Non-current assets	316,394	340,127
Total Assets	376,265	384,076
Current liabilities	65,522	77,473
Non-current liabilities	137,657	111,305
Total liabilities	203,179	188,778
Net assets	173,086	195,298

The increase in current assets represents additional tax assets of \$10.3 million from losses.

The decrease in non-current assets was mainly due to the impairment on plant and equipment.

Non-current liabilities increased due to additional borrowings of \$27.2 million to fund capital projects. Liabilities include a \$35.1 million provision for rehabilitation of landfill sites (\$38.2 million at 30 June 2009).

Corporation Activities

The Corporation is a statutory State owned corporation constituted under the *Waste Recycling and Processing Corporation Act 2001* to provide a waste processing, recycling and disposal service. It manages waste management centres, including eight solid waste transfer stations, four engineered landfills, three materials recycling facilities and operates a waste and recycling collection business.

For further information on the Corporation, refer to www.wsn.com.au.

Section Four

Performance Audit

Electronic Information Security

Electronic Information Security

On 20 October 2010, I tabled a report on my performance audit 'Electronic Information Security'.

The criterion for that audit was that the Government should be able to show that those systems which hold personal information are certified to comply with the international Information Security Management Systems standard - ISO27001. The criterion was derived from the Government's policy on Security of Electronic Information described in Ministerial Memorandum 2007-04.

Originally, I planned to have two additional criteria, that is:

- personal information held on selected databases is adequately protected from unauthorised access
- unencrypted sensitive personal information is rarely emailed outside the selected agencies.

During the audit, I decided to address these as a 'special review'.

To reach a conclusion on these criteria, I engaged experts to undertake penetration testing and high-level scanning of email content on two agencies who are currently certified to ISO27001.

Conclusion

The testing performed by our experts found no major security flaws in either agency. This positive outcome suggests that the international standard is a good basis for building strong electronic information security.

I also concluded that penetration testing and email scanning are worthwhile tools to identify security issues and obtain assurance of robust defences against unauthorised access to data, although no doubt there are a range of such tools available.

Opportunities for Improvement

While no major flaws were found, the testing did reveal several opportunities to improve electronic information security. The following is a summary of the main weaknesses found by my experts and potential remedial actions. While noting these are not major issues, the agencies involved have advised they will analyse these issues and take appropriate corrective action in accordance with their established risk management procedures.

Security issues identified in technical testing

Issue	Explanation	Possible remedial action
Database access not secured in web applications	SQL injection is a hacking technique whereby the hacker sends illicit commands through a web application for execution by the backend database. It is perhaps one of the most common attack techniques currently used with the usual object being data theft.	This form of attack takes advantage of improper coding of applications, so it can be readily countered through best practice coding techniques such as: <ul style="list-style-type: none"> server-side sanitisation routines restricting the use of dynamic SQL replacing SQL in web application code with calls to stored procedures.
Failure to terminate remote access sessions	Session hijacking refers to the exploitation of a valid computer session to gain unauthorised access to information or services in a computer system. When a remote user ceases to use a web application the session must be terminated. Not doing so provides an opportunity for a hacker to hijack the session and penetrate security.	Sessions can be configured to end after a short period of inactivity or when system errors are detected.
Transmission of data between systems and remote applications in easily read and modifiable form	Sniffing refers to the act of intercepting the transmission of data between systems and remote applications. Transmissions in plain text format are problematic. Where the data is the user's identification and password sniffing provides an opportunity for spoofing - impersonating the user to breach the agency's security perimeter. Where the data is private information, its interception can result in data theft or unauthorised modification in transit.	This can be addressed through encryption of all such traffic.
Weak encryption methods	Encryption is the security process of converting text or data into a coded form unreadable to anyone without the specific key. Weak ciphers can easily be decrypted giving the hacker access to agency information.	Strong ciphers are recommended, as well as application of encryption to cookies because these can contain session parameters.
Login credentials stored by the user's web browser	Login credentials can be stored by some users' web browsers. This can potentially permit unauthorised personnel with access to the computer gain access to the agency's systems.	Disabling of auto-complete on all web applications' login forms is recommended.
Out of date operating system software with known vulnerabilities	Out of date operating systems software with a memory-corruption vulnerability in Server Message Block (SMB, also known as Common Internet File System) can permit a hacker to execute code on the server (such as install applications, create accounts or modify data) or perform a denial of service attack upon it.	A regime involving the timely installation of patches is recommended.

Appendix 1

Agencies not reported elsewhere in this volume

The following audits resulted in unqualified independent auditor’s reports and did not identify any significant issues or risks.

Entity name	Website	Period/year ended
Corporation Sole ‘Minister Administering the Heritage Act, 1977’	www.heritage.nsw.gov.au	30 June 2010
Arts Education Foundation Trust	*	30 June 2010

* This entity does not have a website.

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