

Audit Report No. 50, 2003-2004

Management of Federal Airport Leases

Background

6.1 Between 1997 and 2003, a total of 22 airports owned and operated by the Commonwealth were privatised. The sales were conducted in five stages and raised aggregate proceeds of \$8.5 billion. The ANAO conducted performance audits of the sales of 17 of these airports and tabled its report in Parliament (Audit Report No. 50 2003-2004, *Management of Federal Airport Leases*) in June 2004.

6.2 The ANAO analysis of airport leases covered the following airports:

Adelaide	Canberra	Jandakot (WA)	Mount Isa
Alice Springs	Coolangatta	Launceston	Parafield (SA)
Archerfield (Qld)	Darwin	Melbourne	Perth
Brisbane	Hobart	Moorabbin (VIC)	Tennant Creek
			Townsville

- 6.3 The airports privatisation program involved leasehold, rather than freehold sales. As a result, the Commonwealth has an ongoing involvement in airport operations. The Department of Transport and Regional Services (DOTARS) is responsible for administering the Commonwealth's ongoing interests in the operation and management of Federal airports under both the statutory regulatory framework of the *Airports Act 1996* (Airports Act), and the contractual arrangements entered into as part of the sales processes.
- 6.4 A number of legal agreements were used to facilitate each of the sales. In terms of ongoing Commonwealth involvement in airport operations, the major sale documentation comprised:
- a Sale Agreement between the Commonwealth, the lessee and its parent entities;
 - an Airport Lease between the Commonwealth and an airport lessee company; and
 - for the major airports, a tripartite deed between the Commonwealth, the lessee and the lessee's financiers.
- 6.5 The focus of the audit was on DOTARS' administration of these agreements.

The audit

- 6.6 The objectives of the audit were to assess whether DOTARS had developed and implemented an appropriate framework and the procedures to administer lessee obligations entered into as part of the 1997 and 1998 leasehold sales of 17 Federal airports. In particular, the audit sought to:
- review DOTARS' monitoring of lessee compliance with the Airport Leases and supporting sale documentation;
 - examine the effectiveness of the framework and procedures developed by DOTARS to administer lessee development commitments; and
 - assess the impact of changes in the aviation environment on the management and monitoring of lessee obligations.
- 6.7 The scope of the audit included assessing the Department's management of lessees' development obligations under the sale documentation and its management of lessee compliance with other contractual obligations.

Audit findings

- 6.8 Since the sales, significant changes have occurred in the Australian aviation market, which have increased the challenges facing DOTARS in its regulatory and contract management roles.
- 6.9 In terms of the audit objective, the ANAO found that DOTARS took some time to develop procedures to administer important aspects of lessees' contractual obligations. DOTARS indicated to the ANAO that the approach taken was influenced by the impact of changes in the aviation environment.¹ Commencing in 2002, the Department took steps in a number of areas to improve its contract management approach. The ANAO considered that further attention was required in a number of areas, including:
- reasonable cost recovery for lease administration;
 - more regulated lease reviews, including more efficient follow-up work on outstanding issues resulting from lease reviews; and
 - improvements in relation to effective monitoring and reporting on airport development commitments.
- 6.10 The ANAO also commented that it had identified inaccuracies in DOTARS' reporting on its performance in managing the Airport Leases and Sale Agreements.

ANAO recommendations

- 6.11 The ANAO made nine recommendations in total. DOTARS agreed to six recommendations, and agreed with qualification to the remaining three recommendations:²

Table 6.1 ANAO recommendations, Audit Report no. 50, 2003-04

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| 1. | <p>ANAO recommends that DOTARS assure itself that the required insurance policies are in place at privatised Federal airports by:</p> <ul style="list-style-type: none"> (a) adopting contracting procedures that provide the Department with ongoing access to expert, independent advice on lessees' insurance policies; and (b) promptly resolving any uncertainty where it is not clear that the required insurance is in place. |
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DOTARS response: Agreed.

1 Since the commencement of the airports privatisation process, significant changes have occurred in the aviation environment. This has included successive aviation industry shocks caused by the Asian economic crisis of 1998-99, the events of September 11 2001, the collapse of Ansett on 12 September 2001, the October 2002 Bali bombing, the SARS pandemic during 2002-03, and the Iraq war.

2. ANAO recommends that DOTARS record the letters of comfort issued in relation to airport sub-lessees on the Department's Register of Contingencies and implement appropriate safe custody arrangements for the instruments.
DOTARS response: Agreed.
 3. ANAO recommends that, consistent with the Commonwealth's cost recovery policy for regulatory agencies, DOTARS implement a rigorous system for quantifying the reasonable costs of its administration of the 22 Federal Airport Leases, in order to:
 - (a) identify the amount of resources required to administer the contracts entered into at the time of the various sales; and
 - (b) consider the merits of exercising the Commonwealth's contractual rights to recover from lessees the Department's lease administration costs.***DOTARS response:*** Agreed.
 4. ANAO recommends that DOTARS improve its management of the Airport Leases by developing and implementing reliable systems for the scheduling and conducting of annual lease review meetings, and reporting on its performance in conducting these reviews.
DOTARS response: Agreed with qualification.
 5. ANAO recommends that DOTARS enhance its conduct of lease review meetings by, at the conclusion of each review:
 - (a) documenting review outcomes, including the Department's assessment of the degree to which the lessee complies with the sale documentation requirements; and
 - (b) providing a written response to the lessee specifying outstanding issues that are to be addressed.***DOTARS response:*** Agreed.
 6. ANAO recommends that DOTARS include in future Annual Reports comprehensive and accurate performance information on the timeliness and completeness of receipt of expenditure plans and audited reports on Development Commitment expenditure from relevant airport lessees.
DOTARS response: Agreed with qualification.
 7. ANAO recommends that DOTARS more closely analyse annual expenditure reports when they are provided in order to promptly advise lessees of any items that the Commonwealth would not accept as expenditure towards the Development Commitment obligations.
DOTARS response: Agreed.
 8. ANAO recommends that, having regard to the delays that occurred for Period One, DOTARS expedite the finalisation of Period Two Development Commitment outcomes, currently due in 2007 and 2008, by taking early administrative action to obtain, analyse and assess financial reports prepared by Approved Auditors.
DOTARS response: Agreed.
 9. ANAO recommends that DOTARS report achievement against the Period One Development Commitment for each airport in its next Annual Report.
DOTARS response: Agreed with qualification.
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The Committee's review

- 6.12 On 7 March 2005, the Committee held a public hearing in Canberra to review DOTARS' progress in light of the nine recommendations made in the ANAO audit report. The public hearing was attended by DOTARS and the ANAO.
- 6.13 The Committee took evidence on the following issues:
- DOTARS' resourcing and cost recovery;
 - lease management;
 - lease reviews; and
 - aeronautical infrastructure development.

Cost recovery for administering airport leases

- 6.14 The ANAO report concluded that DOTARS had given insufficient attention to resourcing important aspects of managing the Airport Leases and Sale Agreements. With limited budget-funded resources available to DOTARS for both regulatory and contract management functions, the ANAO suggested that DOTARS needed to identify other means of appropriately resourcing its contract management responsibilities. This included considering the merits of exercising the power provided by the lease for DOTARS to recover its reasonable lease administration costs.³
- 6.15 Recommendation three in the audit report asked that DOTARS quantify the reasonable costs of its administration of the 22 airports in order to:
- identify the amount of resources required to administer the contracts entered into at the time of various sales; and
 - exercise the contractual rights to recover from lessees the Department's lease administration costs.
- 6.16 DOTARS updated the Committee on the progress of its implementation of this recommendation. The Committee was advised that it was the Department's understanding that 'potential purchasers of the airport leases had been advised prior to purchase that these

3 ANAO Audit Report no. 50, 2003-2004, *Management of Federal Airport Leases*, Commonwealth of Australia, June 2004, p. 10.

costs would not be recovered.⁴ Further to this DOTARS commented that:

Legal advice relating to the difficulty of recovery of lease administration costs has been received and a paper is now being prepared for consideration by the Department's Audit Committee.⁵

- 6.17 During the public hearing DOTARS reiterated this view and commented that the results from the Department's audit committee could be provided to the Committee.

We have just finalised a review that is currently under consideration by the department's audit committee about a revised policy towards recovery of reasonable costs on leases. We go to our audit committee this Thursday. I am happy to provide you with the results of that.⁶

- 6.18 At the public hearing DOTARS informed the Committee that there would be no retrospective cost recovery.⁷

- 6.19 The Committee asked DOTARS whether they had an estimation of the cost to the Department for administering the leases. DOTARS commented that Acumen Alliance had looked at this particular question of lease management functions and had made an estimate of the staffing and departmental administrative costs of this particular function of \$242,000 per annum across the 22 airports.⁸

- 6.20 In breaking down the estimate per annum, the relevant DOTARS manager commented that:

There are 35 people within my branch who have oversight responsibility for the 22 airports. It is split across four different sections...The lease management function I would say is a minor component of the overall work of the organisation, as reflected by that \$242,000 cost. We do annual lease reviews. That would take one or two people part of their time per annum.⁹

4 DOTARS, Submission no. 7, p. 2.

5 DOTARS, Submission no. 7, p. 2.

6 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 7.

7 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 9.

8 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 7.

9 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 7.

- 6.21 In short, DOTARS confirmed that 'To put that in context, it is around 1½ staff, full-time equivalent, employed on this activity in the course of a year.'¹⁰
- 6.22 The Committee raised the concern that the cost of recovering administrative costs may be expensive. DOTARS agreed that this was a concern flagged by Acumen Alliance, a consulting firm DOTARS had contracted to advise them on cost recovery. During the public hearing DOTARS commented:
- That is certainly the view of Acumen Alliance. For the amount of costs involved, \$242,000, to separate out the function within the overall branch administration would require time sheets and billing arrangements to be put in place. So there certainly would be costs involved.¹¹
- 6.23 On 17 June 2005, the Committee received advice from DOTARS on the outcome of the Department's review in relation to the recovery of airport lease administration costs. In summary, the review did not support the recovery of airport administration costs.
- 6.24 The two main arguments put forward against the recovery of airport lease administration costs were:
- that advice provided to airport bidders during the Phase 2 sale process 'would seriously undermine the Clause 11.2 contractual right to recover lease administration costs...'; and
 - that the 'work undertaken by external consultants suggests there is some uncertainty on the cost effectiveness of a compliant cost recovery regime should it be introduced'.¹²
- 6.25 Furthermore, DOTARS advised the Committee that it had received legal advice from the Australian Government Solicitor (AGS) which stated that for Phase 2 airports 'there would be legal arguments of substance available to the airport lessees to support the contention that the Commonwealth is not entitled to recover those costs'.¹³
- 6.26 However, AGS did make a comment in relation to Phase 1 of airports which stated that:

10 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 8.

11 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 22.

12 DOTARS, Submission no. 7.1, p.1.

13 DOTARS, Submission no. 7.1, p.2.

...unless similar statements were made in the context of the phase 1 airport sales, there is nothing to suggest that the Commonwealth is not, in reliance upon clause 11.2, able to recover internal departmental administrative costs from those airports.¹⁴

Committee comment

- 6.27 The Committee notes that Phase 1 of the airports privatisation program involved the sale of Brisbane, Melbourne and Perth Airports. With consideration given to the cost of DOTARS billing these airports for the recovery of administration costs, and the fact that the estimated amount recoverable for all 22 airports was \$242 000, the Committee does not consider it worthwhile for DOTARS to pursue the lease administration costs for only three airports.
- 6.28 However the Committee believes it is in the interest of both DOTARS and the Commonwealth in future to embrace cost recovery initiatives, particularly where a clause is initially inserted into the sales contract as it was with the Federal sale of airport leases.

Recommendation 15

- 6.29 **The Committee recommends that in future privatisation programs, government agencies include a clause in all sales contracts which provides for the Commonwealth's cost-recovery of administrative expenses.**

Government agencies should then ensure that they undertake cost-recovery of such expenses as a matter of course.

Lease management

Airport insurance

- 6.30 Appropriate insurance cover for the privatised airports is important to the Commonwealth for a number of financial and other (public
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14 DOTARS, Submission no. 7.1, p.2.

interest) reasons. These include protecting the Commonwealth against claims made against it as landlord, and having the proceeds of insurance claims used to rebuild damaged or destroyed structures. The insurance requirements of lessees are set out in both the Airport Leases and the Sale Agreements.

- 6.31 DOTARS contracts a firm, currently AON¹⁵, to advise on whether insurance taken out by the lessees is in accordance with the Commonwealth's requirements. Between December 2002 and August 2003 insurance reports were completed in relation to each of the seventeen airports included in the audit. The findings revealed that not all the necessary information had been provided to the contractor therefore resulting in most of the insurance reports being qualified. In addition, the contractor found that certain insurances were not in place.
- 6.32 The Committee was greatly concerned about these deficiencies in some of the insurance policies held by the lessees and was disappointed to learn that DOTARS had not followed up on these insurance reports in a timely manner, with two airport insurance reports taking over a year to be followed up.
- 6.33 The table below documents the time taken by DOTARS to follow up on Insurance adviser reports during the time of the audit.

Table 6.2 DOTARS follow-up of Insurance Advisor Reports

Airport	Date of Insurance Advisor Report	Date of DOTARS follow-up	Delay (months)
Adelaide & Parafield	December 2002	February 2004	14
Perth	May 2003	April 2004	11
Brisbane	June 2003	February 2004	8
Darwin, Alice Springs & Tennant Creek	June 2003	March 2004	10
Melbourne & Launceston	July 2003	March 2004	8
Archerfield	August 2003	March 2004	7
Moorabbin	August 2003	December 2003	4
Townsville & Mt Isa	August 2003	February 2004	6
Canberra	August 2003	February 2004	6
Hobart	August 2003	March 2004	7

15 AON is a provider of risk management services, insurance and reinsurance broking, financial planning and employee risks and benefits solutions. At the time of the hearing, AON was contracted to DOTARS until 30 June 2005.

Coolangatta	August 2003	March 2004	7
Jandakot	January 2004	April 2004	4

Source: ANAO analysis of DOTARS information (Audit Report no. 50, 2003-04, p. 41).

6.34 During the public hearing the Committee asked the ANAO to comment on its findings in relation to lack of insurance coverage. ANAO told the Committee:

...in the first series of reports we looked at, which were provided by AON [DOTARS' insurance contractor], across a number of the airports there were either instances where the adviser was unable to conclude that all the required insurances were in place because insufficient information had been provided to the adviser to be able to make a conclusion or some instances where insurances did not appear to be in place.¹⁶

6.35 The Committee sought an assurance from DOTARS that there were no longer any shortfalls in lessees' insurance policies. DOTARS informed the Committee that it was currently awaiting this year's report from AON and told the Committee that this report would identify any existing gaps.¹⁷

6.36 In relation to public liability insurance, DOTARS advised the Committee:

It is my understanding that the airports have had public liability insurance in place. We conduct an annual review and we are in the middle of the current review at the moment. AON, our contractor, is discussing that with all the airports.¹⁸

6.37 In a supplementary submission, DOTARS informed the Committee that 'the Sale Agreements for all leased Federal airports require insurance cover in relation to structures, plant, machinery, revenue loss and legal liability.'¹⁹ See Appendix E for up-to-date *Schedule of Airport Insurance Cover for Federally leased airports from 1997-2005*.

6.38 Recommendation one in the ANAO's report called for a review of procedures in place to ensure that DOTARS kept in place an ongoing insurance contractor to provide advice on lessees' insurance policies.

16 ANAO, *Transcript of Evidence*, 7 March 2005, p. 3.

17 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 3.

18 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 2.

19 DOTARS, Submission no. 7, p. 1.

The recommendation also called for appropriate and timely follow-up action.

6.39 DOTARS advised the Committee of the following action currently in progress in relation to recommendation one:

- The responsibility for airport insurance arrangements has been consolidated with one dedicated officer in the Airport Planning and Regulation Branch.
- The current insurance contract has been reviewed and a decision was scheduled by the end of April 2005.
- The 2004-2005 insurance review is currently underway and is on schedule. To date (26 April 2005), the audit contractor has submitted reports for 15 airports to the Department and they have been/are currently being assessed and follow up action initiated where necessary. However, one airport has not yet provided the required information to the audit contractor for assessment.
- The Department has acted to resolve uncertainty in relation to insurance status. DOTARS advised the Committee that the Sale Agreements for all leased Federal airports require insurance cover in relation to structures, plant and machinery, revenue loss and legal liability. For details of airports' insurance cover from 1997-2005, see Appendix E.²⁰

Committee comment

6.40 The Committee is satisfied that DOTARS is alerted to the need to assure itself that the required insurance policies are in place at privatised Federal airports. However, it urges the Department to follow up immediately on outstanding information related to the insurance review process.

6.41 The Committee recommends that DOTARS adopt a procedure which ensures that all follow up actions required in relation to the audit contractor's insurance reports are finalised within a three month period.

²⁰ DOTARS, Submission no. 7, Attachment B, p. 1.

Recommendation 16

- 6.42 **The Committee recommends that the Department of Transport and Regional Services adopts a procedure which ensures that follow up administration on all insurance reports from the audit contractor are finalised within a three month timeframe.**

The Department's annual report should include a report on the status of all insurance reports from the audit contractor, including the date of the report, and date of any departmental actions arising from the report.

Tripartite deeds

- 6.43 The tripartite deed document was developed late in 1997, during the Phase 1 sales process. The document was prepared to address the concerns of financiers to the bidders for each of the major airports. In the absence of such a document, the financiers considered that they could lose all of their debt funds if a termination event occurred and the Commonwealth cancelled the Airport Lease (over which they had taken security). Tripartite deeds are in place for each of the 12 core regulated airports.²¹

- 6.44 The Committee discussed the issue of Tripartite Deeds during the public hearing. DOTARS outlined when a tripartite deed would be actioned:

Effectively, when a company no longer has the capacity to run an airport, and financiers cannot step in and rectify the situation, the airport returns to the Commonwealth. The Commonwealth's liabilities are limited to the asset value of the airport.²²

- 6.45 The ANAO commented that :

It is probably also a bit more complex in the sense that having adequate insurance in place is not solely a matter of having a policy; one of the requirements of the lease is that the

21 The 12 core regulated airports are: Sydney, Melbourne, Brisbane, Perth, Canberra Coolangatta, Townsville, Adelaide, Hobart, Launceston, Darwin and Alice Springs.

22 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 6.

Commonwealth be named under that policy so that, for example, if we do have to step into the airport, the Commonwealth has the benefit of that lease. Whilst you might have a policy in place today, if that policy does not extend to the Commonwealth, the Commonwealth will not have the benefit of the policy.²³

- 6.46 The tripartite security deeds have been disclosed by DOTARS as a remote administered contingent liability in the Department's financial statements, but without the Commonwealth's exposure being quantified. During the course of the audit, the ANAO canvassed with DOTARS the possibility of quantifying the extent of the Commonwealth's exposure.
- 6.47 DOTARS advised ANAO that it intended to discuss the treatment of the tripartite deeds as a contingent liability with its financial statement auditors in preparation for settling the Department's 2003-04 audited statements.
- 6.48 During the public hearing DOTARS confirmed that they had discussed the issue of tripartite deeds with its financial statement auditors. The Committee noted the following information was included in the DOTARS Annual Report 2003-04 Financial Statements:

The Tripartite deeds between the Commonwealth, airport lessees and lessees' financiers provide for limited step in rights for the financiers in circumstances where the airport lease is terminated. Assuming the financiers' step in rights are not triggered, the potential liability of the Commonwealth can vary under the Tripartite Deed, depending on whether the airport lease is able to be sold on to a third party or not.

The Commonwealth's potential liability to the lessees' financiers is limited to the value received for the affected airport lease or the valuation of the airport site. Where the Commonwealth is able to sell on the airport lease, secured financiers have a limited ability to recover their loans from funds obtained by the Commonwealth from selling on the airport lease, subject to higher ranking claims being met first. Where the airport lease is not sold on, the Commonwealth is required to obtain a valuation of the airport site that will

23 ANAO, *Transcript of Evidence*, 7 March 2005, p. 6.

determine the limit for a repayment (or partial repayment) of financiers' loans again subject to higher ranking claims being met. If the Commonwealth enters into possession of an airport site, it would seek to recover costs from a number of sources, including airport revenues and the airport lessee company, in addition to funds obtained from selling the airport lease.²⁴

Letters of comfort

- 6.49 A letter of comfort is an instrument that is used to facilitate an action or transaction but is constructed with the intention of not giving rise to legal obligations. Commonwealth policy on letters of comfort is that they should be avoided. This is because a letter of comfort may lead to an actual liability, even where this is not the intention.
- 6.50 Between December 1998 and January 2004, DOTARS issued five letters of comfort in relation to the Commonwealth allowing sub-lessees to remain on the airport site as a lessee in the event of early termination by the Commonwealth of the Airport Lease.
- 6.51 During the public hearing the Committee asked DOTARS whether it had issued any other letters of comfort since the audit report. DOTARS officials reported that one further letter of comfort had been issued making a total of six letters of comfort having been issued by the department in relation to airport leases.
- 6.52 Recommendation two in the audit report called for DOTARS to record all letters of comfort on a register of contingencies and implement safe custody arrangements for the instruments. DOTARS agreed with the recommendation and advised the ANAO in April 2004 that these procedures had been implemented. DOTARS stated that the:
- ...letters of comfort have been recorded on the department's register of contingencies, and there are safe-custody arrangements in place for them. So there is a central holding of information, plus a copy in the [Aviation and Airports Security] work area.²⁵

24 DOTARS, *Annual Report 2003-04*, p. 267.

25 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 13.

- 6.53 The Committee was interested to know why letters of comfort were still being issued when it was Commonwealth policy that they should be avoided. DOTARS responded:

Because the airports are on a leasehold basis, financiers and people who want to enter into long-term commitments with them are often nervous, not having dealt with leasehold arrangements and the security, or lack of it that potentially goes with that. The letter from our point of view essentially describes the legal framework and, in describing it, gives some level of comfort in the broad sense as to what that framework does, which would enable someone intending to invest to come to a view about what they are entering into.²⁶

- 6.54 DOTARS reassured the Committee that the letters of comfort are effectively just correspondence to the airport lessee sublease holders. They commented further that:

...the legal advice we have is that they do not constitute letters of comfort in the sense that is normally addressed by this committee, in that they actually do not enter into any binding commitments on the Commonwealth.²⁷

Committee comment

- 6.55 The Committee believes DOTARS should limit the number of letters of comfort issued, in line with Commonwealth policy which states that they should be avoided. Where it is necessary for the Department to issue such a letter, it is important that they be placed on the Department's Register of Contingencies and that safe custody arrangements for the instruments be put in place.

Lease documentation

- 6.56 The Committee was concerned that the ANAO report had identified that there were several original lease documents unaccounted for. The audit report noted an absence of lease documentation for Brisbane, Moorabin, Hobart and Townsville airports.

²⁶ DOTARS, *Transcript of Evidence*, 7 March 2005, p. 15.

²⁷ DOTARS, *Transcript of Evidence*, 7 March 2005, p. 13.

- 6.57 During the public hearing DOTARS told the Committee that the Department held all copies of the leases on its premises and that the originals were held by the Australian Government Solicitor (AGS).

My clear understanding, which I will verify, is that we hold copies of all the leases...²⁸

- 6.58 However, the audit report had verified that there were cases of missing documentation of original leases. When asked about the importance of ensuring that there are copies of the original lease documentation, the ANAO reported to the Committee:

Something we try to point out to all departments is the importance of actually keeping any original documentation where the Commonwealth has sent it in, for the rights and obligations that need to be protected. When we first came up against this in the 1998 report, we made the recommendation that they should be looked after. So, from our point of view, we were just following up to see that they had been looked after. The fact that they cannot be found is a less desirable position.²⁹

- 6.59 After the public hearing, DOTARS advised the Committee in a supplementary submission of the following status in relation to original lease documentation.

The AGS has confirmed that it holds originals of all airport leases except for those of Hobart, Brisbane and Townsville, for which it has obtained copies issued by the Tasmanian and Queensland Land Titles Offices (LTOs). The AGS has advised the Department that copies issued by an LTO are as good as the original.

Originals or electronic copies of originals are held at the LTOs of the state or territory in which the lease was registered. Melbourne airport is the only airport which does not have its lease registered. The AGS is currently making arrangements for the Melbourne Airport Lease to be registered with the Victorian LTO.

At the time of leasing, the AGS provided printed and bound "Administrators' Versions" of the Airport Leases to the Department. The Administrators' Version is not a signed

28 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 11.

29 ANAO, *Transcript of Evidence*, 7 March 2005, p. 11.

copy of the lease, but contains the precise wording of each clause of the lease, with explanations by AGS of the meaning and intention of clauses.³⁰

Annual lease reviews

6.60 The Committee asked DOTARS about changes to its annual lease reviews of airports as a result of the audit report recommendations.

6.61 DOTARS advised the Committee:

We have recently reviewed those in the light of the audit recommendation. I think we have made some improvements there. We developed a new set of guidelines, including checklists and templates for each of the stages of the review, including written responses to the lessees. We have undertaken some training internally as well for our staff. We will be using this new set of guidelines for the next round of lease reviews, including one which will take place in a few weeks time.³¹

6.62 At the public hearing the Committee accepted an exhibit document from DOTARS outlining a list of all the lease reviews conducted in 2003-04 and ones that have been scheduled for 2005. DOTARS stated that 'Essentially they have all been done.'³²

6.63 In addition, DOTARS stated that 'an internal assessment of the risks associated with the management of lease obligations has been undertaken and appropriate risk treatments [have been] included in the new draft Branch Guidelines.'³³

Annual reporting on review performances

6.64 In terms of future reporting on annual lease reviews, DOTARS agreed with the recommendation of the ANAO that the most appropriate focus for such reporting should be through the Department's Annual Report. DOTARS commented that:

30 DOTARS, Submission no. 7, p. 2.

31 DOTARS, *Transcript of Evidence*, 7 March 2005, pp. 12-13.

32 The list of lease reviews is part of DOTARS submission no. 7, Schedule C. DOTARS, *Transcript of Evidence*, 7 March 2005, p. 9.

33 DOTARS, Submission no. 7, p. 3.

We have been consulting with the airports to deal with the very questions you have been raising about the balance between transparency and commercial sensitivity, to find the right balance for reporting.³⁴

- 6.65 DOTARS informed the Committee that the next annual meeting with all the airport lessees was scheduled for May 2005. DOTARS told the Committee:

The Branch will brief the 22 airport lessees on the form of future performance reporting on lease reviews at the Airport Consultative Forum to be held on 5 May 2005.³⁵

Committee comment

- 6.66 The Committee will note with interest the future performance reporting on lease reviews in DOTARS' Annual Report for 2004-2005. The Committee stresses the importance of open and transparent reporting of performance in annual reports to ensure optimal accountability for all Commonwealth entities and the Australian public.

Aeronautical infrastructure development

- 6.67 The ANAO made several recommendations in relation to the delayed reporting of development commitments and the lack of performance reporting of these airports by DOTARS. The Sale Agreements for ten of the airports included a commitment from the lessee to a specified amount of capital expenditure on aeronautical infrastructure development over the first 10 years of the lease. Total Development Commitments of \$699.8 million were specified across the various Sale Agreements.
- 6.68 The 10-year Development Commitments were divided into two five-year periods, defined in the Sale Agreement as Period One and Period Two. For the three Phase 1 airports, Period One was originally specified to end on 30 June 2002. For the seven Phase 2 airports that have Development Commitments, Period One was originally specified to end on 30 June 2003.

34 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 12.

35 DOTARS, Submission no. 7, p. 4.

- 6.69 The ANAO found that DOTARS' development of procedures to administer these Commitments was not timely. In particular, the Department did not commence the development of procedures until 2003, more than five and a half years after the Phase 1 sales were completed.
- 6.70 DOTARS acknowledged to the ANAO in February 2004 that, without agreeing that its flexible approach was inappropriate, earlier implementation of standardised processes and guidelines would have been beneficial. DOTARS further commented that measures are now in place to remedy the issue.
- 6.71 At the public hearing, the Committee accepted an exhibit document from DOTARS titled, *Airport Development Commitment Expenditure as required under Airport Sale Agreements*.³⁶ This exhibit provided the Committee with the most up to date information DOTARS had in relation to Period 1 Airport Development Commitment Expenditure Status. See Appendix F.

Performance reporting

- 6.72 At the public hearing the Committee asked DOTARS to comment on how performance reporting in relation to airport development expenditure was progressing.
- 6.73 DOTARS made the following comment:
- The obligations are split up into two five-year periods determining a total expenditure commitment over a 10-year period between period 1 and period 2. My understanding is that we provided some information in this year's annual report and that we are looking to provide further information in next year's annual report after discussion with the airports.³⁷
- 6.74 DOTARS had some concerns about the appropriateness of the content of the information included in its annual report in terms of performance indicators for each airport lessee. The Department wanted to be sure it did not reveal any commercial-in-confidence material. DOTARS stated:

36 DOTARS, *Airport Development Commitment Expenditure as required under Airport Sale Agreement*, Exhibit no. 3.

37 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 16.

One of the issues we are confronted with effectively on a daily basis is the question of what we actually release in regard to any information provided by the airports. Obviously the fact is that they are commercial entities. Whilst we may consider the information is not something which would be an issue from the point of view of the airport, they do have some concerns from their shareholders and from the question of how it might impact on their business in the way in which it is reported, because it can be misconstrued. Therefore we want to be very careful in regard to how we actually provide further and more elaborate detail to ensure that they are comfortable with the release of the information, given that sensitivity.³⁸

6.75 At the hearing DOTARS commented that:

some information was provided on period 1 development commitment outcomes and was included in our 2003-04 annual report. But, as I said, we are now looking forward to next year's annual report and to what level of information we provide in that.³⁹

6.76 The Committee noted that the only information available in the DOTARS' Annual Report 2003-04 in relation to performance indicators for airport development commitments, confirmed that 'six airport lessees had met their period one development commitment obligations worth more than \$186 million.'⁴⁰

6.77 In a supplementary submission, DOTARS stated that 'the most appropriate format and content of performance reporting for Development Obligations in future Departmental Annual Reports is scheduled to commence at the end of April 2005.'⁴¹

6.78 At the public hearing, DOTARS added the following comment:

It is important to note that the actual amount in total that has been spent by airports in regard to development obligations is far in excess of what was originally required under their agreements. ...Our concern is really more with the fact that the total amount that is acquitted against that five-year period

38 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 16.

39 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 17.

40 DOTARS, *Annual Report 2003-04*, p. 53

41 DOTARS, Submission no. 7, p. 5.

is legitimate expenditure in regard to what is required under the contract.⁴²

6.79 At the end of the public hearing the Committee sought to clarify with DOTARS whether the needs of aviation will be well served in the future in terms of development commitments and growth. DOTARS replied:

...stability and growth have returned to the aviation industry, so the drivers that lead to infrastructure investment at airports are now back in place. You can see across the board at the airports we are dealing with that they all have capital plans that would enable them to meet the sorts of commitments we are talking about.⁴³

Committee comment

6.80 It is important to acknowledge that the Commonwealth has a significant residual interest in the federal airports now leased to private companies and consortiums. The government, through DOTARS, must ensure that these leases are managed properly and in accordance with the lease agreements.

6.81 The Committee understands that DOTARS is responsible for ensuring that the airport development obligations are carried out in a timely manner and that they meet the obligations set out in the Sale Agreements.

6.82 The Committee recommends that DOTARS report more fully on whether or not the ten airport lessees have met their airport development obligations in a timely manner. This includes reporting on lessees who have not provided the Department with the information required or have not supplied the Department with information in a timely manner. This would include DOTARS reporting on extension dates that have been granted to lessees.

42 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 19.

43 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 18.

Recommendation 17

- 6.83 **The Committee recommends that the annual report of the Department of Transport and Regional Services include a matrix reporting on each airport lease - including the status of annual lease reviews, insurance reports, development obligations, letters of comfort and cost recovery of administrative expenses.**

Where time extensions for development obligations have been granted, DOTARS must provide a comprehensive explanation detailing why the extension has been approved.