

The Auditor-General
Audit Report No.8 2006–07
Performance Audit

Airservices Australia's Upper Airspace Management Contracts with the Solomon Islands Government

Airservices Australia

Australian National Audit Office

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of Australia 2006

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Canberra ACT
18 October 2006

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in Airservices Australia in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *Airservices Australia's Upper Airspace Management Contracts with the Solomon Islands Government*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations and Glossary

Air navigation fee revenue	The air navigation fee payable by owners/operators of aircraft flying through upper airspace of the Honiara Flight Information Region set by the <i>Air Navigation (Air Traffic Control) Regulations 1998</i> of the Solomon Islands <i>Civil Aviation Act 1986</i> .
Air Services Act	<i>Air Services Act 1995</i>
ANAO	Australian National Audit Office
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CASA	Civil Aviation Safety Authority
Chicago Convention	The Convention on International Civil Aviation concluded at Chicago on 7 December 1944.
DOTARS	Department of Transport and Regional Services
Flight Information Region (FIR)	An airspace of defined dimensions allocated by the International Civil Aviation Organization. A basic level of air traffic service is required to be provided within each FIR. This involves a flight information service for the safe and efficient conduct of flights and alerting the relevant airspace authorities should an aircraft be in distress. Higher levels of air traffic advisory and control services may be provided within certain portions of airspace within a FIR, depending on the class of that portion of airspace.
GBE	Government Business Enterprise
GPS	Global Positioning Satellite
ICAO	International Civil Aviation Organisation, formed under Article 43 of the Chicago Convention.
TAAATS	The Australian Advanced Air Traffic System

Summary and Recommendations

Summary

Introduction

1. Airservices Australia is a Commonwealth statutory authority established by the *Air Services Act 1995* (Air Services Act). Airservices Australia's legislated functions include airspace management, air traffic flow management, air traffic control services, flight information and aviation rescue and fire fighting services. Its airspace management role is carried out in accordance with the Convention on International Civil Aviation (Chicago Convention), to which Australia is a contracting state.¹

2. The world's airspace is divided into a series of contiguous Flight Information Regions (FIRs) within which air traffic services are provided. Australia has two FIRs, which collectively cover more than 11 per cent of the globe. In this respect, the Melbourne and Brisbane FIRs include Australia's sovereign airspace as well as international airspace over the Pacific, Indian and Southern Oceans.²

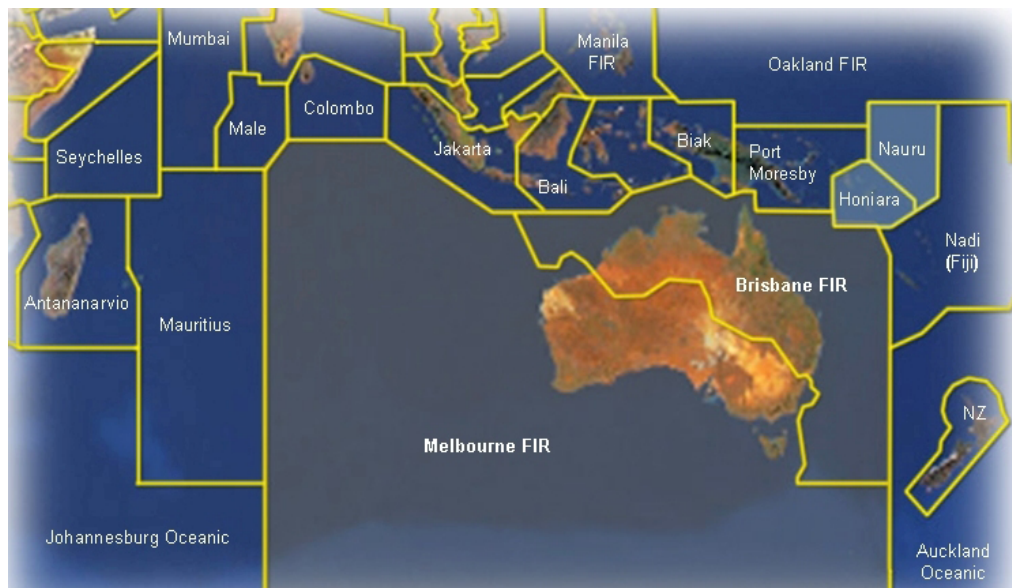
3. In addition to airspace allocated to Australia under the Chicago Convention, Airservices Australia has entered into contracts with the relevant governments to manage the upper airspace in the Honiara and Nauru FIRs (see Figure 1). These contracts were entered into as part of an Airservices Australia strategy to be the major provider of air space management and related services in the southern hemisphere. The Honiara and Nauru FIRs do not involve high traffic levels and the amount of revenue earned under the contracts represents less than two per cent of Airservices Australia's total commercial revenue.

¹ Amendments to the the *Air Navigation Act 1920* passed by the Parliament in 1947 approved the ratification on behalf of Australia of the Chicago Convention.

² The Air Services Act defines "Australian-administered airspace" as: the airspace over Australian territory; airspace that has been allocated to Australia by the International Civil Aviation Organization (ICAO) under the Chicago Convention and for which Australia has accepted responsibility; and airspace administered by Australia at the request of another country.

Figure 1

South East Asia and Indian Ocean Airspace



Source: Airservices Australia

The upper airspace management contracts with the Solomon Islands Government

4. There have been two upper airspace management contracts between Airservices Australia and the Solomon Islands Government. The first was made on 27 April 1998. It ran for five years, commencing on 1 June 1998. A second contract was made on 21 May 2003, to run for a further ten years. The terms of the second contract were substantially the same as the 1998 contract.

5. The upper airspace management contracts have involved Airservices Australia providing two distinct but related services:

- management of the Honiara upper airspace; and
- collection agent³ in relation to statutory air navigation fees collected from airlines using the Honiara upper airspace, and the remittance of those fees to the Solomon Islands Government.

³ The Solomon Islands Air Navigation (Air Traffic Control) Regulations were amended to specify that Airservices Australia was authorised by contract to collect the air navigation fees for the upper airspace.

6. In relation to this second role, the upper airspace management contracts have provided for air navigation fee revenue of the Solomon Islands Government, collected on its behalf by Airservices Australia, to be remitted to a specified Solomon Islands Government bank account. The contracts required that this revenue be remitted once a month, after Airservices Australia had deducted its monthly contract fee. The contracts also permitted Airservices Australia to retain any amounts due to it under other contracts with the Solomon Islands Government for civil aviation development projects.

7. Shortly after the first contract commenced on 1 June 1998, Solomon Islands Government Ministers and officials began to make requests to Airservices Australia for payments of air navigation fee revenue to third parties. The contracts did not provide for these payments to be made. Requests were received from the relevant Solomon Islands Government Minister, the Permanent Secretary of the relevant Department and the Controller of Civil Aviation (the representative of the Solomon Islands Government nominated in the contract).

8. The majority of the payments made by Airservices Australia outside the terms of the contracts were to third parties, and totalled some \$2.1 million. In addition, Airservices Australia corporate credit cards were used to provide cash advances to individuals (mainly Solomon Islands Government Ministers and officials) and make payments to third parties, with Airservices Australia reimbursing itself from the air navigation fee revenue it was holding on behalf of the Solomon Islands Government. Funds were also remitted to Solomon Islands Government bank accounts other than the one specified in the upper airspace management contract then in force.

Minister's request for an ANAO audit

9. On 5 May 2006, the then Minister for Transport and Regional Services, the Hon Warren Truss MP, wrote to the Auditor-General requesting that consideration be given to undertaking a performance audit of the administration by Airservices Australia of its contracts with the Solomon Islands Government for upper airspace management.

10. The Minister's request arose from a review of civil aviation by the Solomon Islands Auditor-General, including the upper airspace management contracts with Airservices Australia. This review had identified irregularities in the administration of air navigation fee revenue collected by Airservices Australia on behalf of the Solomon Islands Government.

11. The Solomon Islands Auditor-General tabled his report in the Solomon Islands Parliament in October 2006.

Audit objectives

12. On 9 May 2006, the Auditor-General advised the then Minister for Transport and Regional Services that he would undertake a performance audit and that the specific audit objectives and approach would be established once officers of the Australian National Audit Office (ANAO) had the opportunity to undertake preliminary enquiries with senior staff in Airservices Australia and the Department of Transport and Regional Services (DOTARS).

13. On 31 May 2006, the Auditor-General designated a performance audit under Section 18 of the *Auditor-General Act 1997* (Auditor-General Act). The objectives of the performance audit were to:

- examine the development and administration by Airservices Australia of its contracts with the Solomon Islands Government for upper airspace management;
- assess the regularity of payments made under the contracts and steps taken by Airservices Australia in respect of any irregularities; and
- make recommendations for any improvements in the processes employed by Airservices Australia in developing and administering these and similar contractual arrangements.

Overall audit conclusions

14. Airservices Australia's administration of the payment of air navigation fee revenue to the Solomon Islands Government departed significantly from the approach specified in the written contracts. Specifically, more than \$2.1 million (20 per cent of all payments from the air navigation fee revenue) was paid outside the terms of the upper airspace management contracts. This amount comprised:⁴

- a total of 305 payments to third parties between February 1999 and September 2003 amounting to \$2.10 million. The main categories comprised fees and expenses of an aviation adviser contracted to the Solomon Islands Government, education expenses for Solomon Islanders studying at academic institutions in a number of countries, and travel expenses; and
- a total of 17 cash advances and payments totalling \$28 558 made using Airservices Australia corporate credit cards. This amount principally related to travel allowances and travel expenses.

15. Airservices Australia relied upon authorisation from Solomon Islands Government Ministers and officials as sufficient basis to depart from the terms of the written contract when making payments from the air navigation fee revenue. This was not only a departure from sound contract management practices but was not prudent given the number and variety of payment transactions. The manner in which these transactions were processed as deductions from air navigation fee revenue may also have contributed to any irregularities in the use of this revenue by Solomon Islands Government Ministers and/or officials.

16. Nevertheless, there was no evidence to indicate that payments had been made by Airservices Australia to secure or retain the upper airspace management contracts with the Solomon Islands Government. In addition, a separate investigation by the Australian Federal Police concluded there was no evidence to support a charge of criminal conduct contrary to Commonwealth law by any Airservices Australia employee.

17. In developing and administering the upper airspace management contracts with the Solomon Islands Government, Airservices Australia was

⁴ Further details are provided in Chapter 4 of this report.

principally concerned with managing its commercial interests and related risks. This commercial focus overshadowed Airservices Australia's broader responsibilities as a Commonwealth statutory authority incorporated by an Act of the Australian Parliament for a public purpose. In particular, Airservices Australia did not:

- Document an assessment of whether its enabling legislation permitted it to contract to administer airspace allocated to other countries.
 - Written legal advice obtained by DOTARS and Airservices Australia during the course of this audit has concluded that the legislation in place at the time the contracts were made provided sufficient authority for Airservices Australia to enter into the upper airspace contracts.
 - However, the legal advices drew attention to differing views as to whether the Australian Government authorised Airservices Australia to enter into the contracts with the Solomon Islands Government and whether the Honiara FIR is "Australian-administered airspace" for the purposes of the Air Services Act. Airservices Australia advised ANAO in September 2006 that it accepts the advice obtained by DOTARS on this issue.
- Identify and assess the nature of the relationship established between itself and the Solomon Islands Government arising from the revenue collection and repatriation elements of the contracts. Specifically, the arrangements resulted in Airservices Australia becoming the contracted collection agent of the Solomon Islands Government.
 - Airservices Australia has not fully met its duty to exercise due care and diligence, avoid conflicts of interest and keep proper and full accounts of all transactions.
- Obtain an understanding of the requirements of the Solomon Islands Constitution governing the collection and remittance of Solomon Islands Government revenue.
 - Developing such an understanding was necessary for Airservices Australia to properly discharge its duties as the collection agent of the Solomon Islands Government.
 - Such an understanding would also have provided Airservices Australia with a sound basis on which to query or decline the

various payment requests received, each of which was contrary to the provisions of the written contracts.

- Adequately investigate the nature of the payments being made when concerns were first raised (in June 2001).
 - In particular, a substantive evaluation by Airservices Australia of its administration of the contracts, and the payments being made, was not undertaken until July 2003.
 - Until two internal reviews were conducted in 2003, Airservices Australia had considered payments to third parties and the credit card transactions to be appropriate. Following discussions with the office of the then Minister, payments outside the terms of the contract were stopped in September 2003.
 - A reconciliation of all financial transactions was not undertaken until July 2005. This was as part of an internal audit that was initiated as a result of a June 2005 visit to Airservices Australia by the Office of the Solomon Islands Auditor-General.

18. For public sector entities, there may be tensions between the pursuit of strategies that promote commercial objectives and the obligations that arise from being established for a public purpose. The audit conclusions underline the potential for such tensions to give rise to risks that require prudent management. Appropriately managing such risks requires public sector entities to understand their authority to enter into contracts, and their obligations under those contracts, paying particular attention to significant or unusual transactions. Sound governance arrangements also involve effective mechanisms to guide officers in their conduct and to respond appropriately when concerns are raised.

19. Airservices Australia has advised ANAO that it has embarked on a widespread reform process with particular reference to the assessment and management of commercial activities. This includes a recent restructure of the organisation, building or rebuilding business systems and improving governance arrangements. It has also embarked on a leadership program for the management team which is aimed at changing the way decisions are made and implementing more effective behaviours and teamwork with a longer-term objective of changing the culture of the organisation. There is also a renewed emphasis on internal auditing reflected in a more extensive program of audits.

Key Findings

Legislative restrictions on Airservices Australia's commercial activities (Chapter 2)

20. As a statutory authority, Airservices Australia relies on the powers conferred on it by its enabling legislation in seeking to earn commercial revenue. The Air Services Act was amended in September 2003 to expand the scope of Airservices Australia's statutory functions so that it may pursue additional commercial opportunities overseas and in Australia. As the upper airspace contracts with the Solomon Islands Government were made in April 1998 and May 2003, these amendments did not apply to Airservices Australia's capacity to enter into either of these contracts.

21. In September 2006, Airservices Australia advised ANAO that, at the time the first contract was signed, it had satisfied itself that it had the legislative power under the Air Services Act to perform the services. However, any analysis underpinning this conclusion was not documented by Airservices Australia. Examination during ANAO's audit of general legal advice obtained by Airservices Australia in March 2002 on the authority's capacity to enter into commercial ventures raised issues about whether Airservices Australia was, in fact, empowered by the enabling legislation in place prior to the September 2003 amendments to enter into the upper airspace management contracts.

22. In addressing the issues raised by Airservices Australia's March 2002 legal advice, both Airservices Australia and DOTARS have, in the course of this performance audit, obtained legal advice that has concluded that Airservices Australia's enabling legislation (as it then was) empowered it to enter into the upper airspace management contracts with the Solomon Islands Government. However, DOTARS and Airservices Australia have received differing legal advice on whether or not:

- the Australian Government authorised Airservices Australia to enter into contracts such as the upper airspace management contracts with the Solomon Islands Government; and
- the Honiara FIR is "Australian-administered airspace" for the purposes of the Air Services Act.

23. Subsequently, DOTARS and Airservices Australia have reached a shared understanding that, as at the date of formation of the first contract in

1998, Airservices Australia was empowered to enter into the contract and it was therefore not necessary that Solomon Islands airspace become “Australian administered airspace”.

The nature of the contractual relationship with the Solomon Islands Government (Chapter 3)

24. At the time of entering into the upper airspace management contracts, Airservices Australia did not identify and assess the nature of the relationship established between itself and the Solomon Islands Government by the revenue collection and repatriation elements of the contracts. This shortcoming existed in two respects.

- Firstly, although Airservices Australia negotiated and signed a contract for it to collect statutory revenue of the Solomon Islands Government, it did not seek to identify the requirements and conditions that needed to be satisfied in remitting the air navigation fees to the Solomon Islands Government. Specifically, Airservices Australia did not appreciate that all air navigation fee revenue it was collecting on behalf of the Solomon Islands Government was required to be remitted, without any deductions being made, to the Consolidated Fund of the Solomon Islands Government.
- Secondly, until 2006, Airservices Australia reported to the Australian Parliament, and advised Australian Government Ministers, that the air navigation fee revenue collected on behalf of the Solomon Islands Government was held on trust. However, in June 2006, the nature of the relationship was assessed. The conclusion reached was that a trust had not been created. Instead, there is an agency relationship between the Solomon Islands Government (as principal) and Airservices Australia (as agent). In this context, as a collection agent, Airservices Australia owes the Solomon Islands Government particular duties, which it has not fully met.

Regularity of payments (Chapter 4)

25. The upper airspace management contracts provided for air navigation fee revenue collected on behalf of the Solomon Islands Government by Airservices Australia to be paid as follows:

- to Airservices Australia for its fees under the upper airspace management contract and fees under any other contracts with the Solomon Islands Government; and

- to the Solomon Islands Government bank account specified in the contract.

26. The majority (\$8.45 million or 80 per cent) of all payments made by Airservices Australia between June 1998 and April 2006 from air navigation fee revenue collected on behalf of the Solomon Islands Government related to either amounts retained by Airservices Australia as fees for its services, or remittance of air navigation fee revenue to a Solomon Islands Government bank account (but not always the specified account).⁵

27. The remaining transactions (totalling \$2.12 million) involved:

- Payments to third parties, the main categories of which were:
 - \$306 162 was paid between September 1999 and August 2003 for travel expenses, including for the purposes of accommodation, daily allowances and airfares;
 - \$391 478 paid between February 2000 and September 2003 in relation to student education expenses.⁶ This included amounts for accommodation, daily spending money, tuition fees and airfares. From the limited information available within Airservices Australia for the transactions examined by ANAO, it appears that the Solomon Islands Government intended to employ these students in the Civil Aviation Division following the completion of their studies, or to retain them in employment if previously working for the department responsible for civil aviation;
 - \$588 339 paid between May 2001 and September 2003 for the fees and expenses of an aviation adviser to the Solomon Islands Government; and
 - \$809 685 in payments to other third parties including: \$208 312 for insurance, \$136 802 for vehicles and vehicle repairs, \$107 104 to Solomon Islands airport contractors, \$42 730 for supplies and equipment, \$38 471 for airfield maintenance, and \$31 658 in salaries and wages.

⁵ Of the amount remitted to Solomon Islands Government bank accounts, \$3.19 million was paid to a bank account specified in one of the upper airspace management contracts. A further \$825 000 was paid to a Solomon Islands Government bank account that was not specified in the contracts.

⁶ Courses undertaken included law degrees, electronic degrees and mechanic engineer training, in a number of countries including Australia, New Zealand, Fiji and Vanuatu

- Cash advances and payments totalling \$28 558 made using Airservices Australia corporate credit cards with subsequent reimbursement from air navigation fee revenue being held on behalf of the Solomon Islands Government. The corporate credit card transactions principally related to travel allowances and travel expenses.

28. Third party payments and credit card transactions were requested by Solomon Islands Government Ministers and officials. However, they were not in accordance with the upper airspace management contracts.

29. By Solomon Islands Government Ministers and officials making the various requests to Airservices Australia, and Airservices Australia making payments from the air navigation fee revenue in the manner requested, it could be argued that the parties had agreed to informally vary the contracts. This is despite the contract providing for variations to be made in writing. However, even if variations allowing the payments had been made in writing, in the context of an Australian government entity collecting revenue on behalf of the government of another sovereign nation, making such payments was not prudent.

Action taken by Airservices Australia (Chapter 4)

30. Between June 2001 and November 2005, Airservices Australia conducted a total of four internal reviews or audits that examined payments made from air navigation fee revenue collected on behalf of the Solomon Islands Government. Over that period, there has been a considerable change in Airservices Australia's assessment of its performance in administering these payments, as follows:

- the first review in 2001 concluded that there was minimal exposure for Airservices Australia as all payments were authorised by the Solomon Islands Government;
- an internal audit undertaken in July 2003 concluded that the contract appeared to be well managed and that, as well as ensuring a high standard of ongoing accountability, the management of the contract had promoted Airservices Australia's and Australia's interests with the Solomon Islands Government. However, concerns were raised that the contract was not being managed strictly in accordance with its terms and conditions;
- an inquiry by Airservices Australia's Office of Security Risk Management, that commenced in August 2003, concluded that payments had been made

other than as provided for by the contracts, although written authority had been obtained for payments to third parties and receipts obtained where cash payments had been made. The review also raised a concern that there may be a perception of corruption as payments made directly to third parties rather than the designated Solomon Islands Government bank account would not be visible for normal audit purposes by Solomon Islands Government officials; and

- the final internal review, an audit completed in November 2005, concluded that payments had been made to third parties that were potentially outside the strict terms of the agreement and that improvements were required in relation to the management of monies on behalf of a customer.

31. In September 2003, as a result of the two internal reviews conducted that year, Airservices Australia ceased making payments other than those explicitly provided for in the upper airspace management contracts. Until this time, Airservices Australia had considered such payments to be appropriate.

Quarantining of Solomon Islands revenue for civil aviation purposes (Chapter 4)

32. To allow an external entity to collect its statutory revenue, the *Air Navigation (Air Traffic Control) Regulations 1998* of the *Civil Aviation Act 1986* were amended by the Solomon Islands Government. As a result of the amendments, these Regulations specify that Airservices Australia is authorised to collect the air navigation fees for the upper airspace. In this respect, Airservices Australia is a collection agent of the Solomon Islands Government.

33. Governments raise statutory fees and charges by compulsion. Accordingly, it is common for the relevant constitution to require a clear separation between the collection of revenue and its subsequent appropriation for expenditure by the relevant Parliament. In this respect, the Solomon Islands Constitution requires that 'all revenues or other moneys raised or received by or for the purposes of the Government be paid into and form one Consolidated Fund'.

34. In this context, Airservices Australia would have been better placed to meet its obligation as the Solomon Islands Government's collection agent for air navigation fees had it identified the requirements that needed to be satisfied in remitting statutory fees to the Solomon Islands Government. In addition, obtaining such an understanding would have provided Airservices

Australia with a sound basis on which to query or decline the various payment requests received from Solomon Islands Government Ministers and officials.

35. With effect from 31 October 2005, the Solomon Islands Government has established an Aviation Special Fund to quarantine the air navigation fee revenue for civil aviation purposes. This arrangement requires that all air navigation fee revenue be paid into the Aviation Special Fund. Accordingly, there appears to be a tension between the requirements of the Aviation Special Fund and the terms of the contract, which allows Airservices Australia to deduct its fees before remitting the balance of air navigation fee revenue to the Solomon Islands Government. In these circumstances, Airservices Australia should seek to resolve this issue as soon as practicable.

Improvement opportunities

36. Airservices Australia has recently been restructured. Concurrent with the restructure, it has been conducting a business improvement program. In addition, the internal audit function has been reviewed and reengineered. There have also been steps taken to address gaps in the authority's approach to managing risk in its off-shore activities.

37. Such changes address a number of the governance shortcomings that were evident from these audit findings. Nevertheless, there are a number of issues that have not yet been addressed. In this respect, ANAO has made four recommendations relating to Airservices Australia:

- with DOTARS, resolving the current uncertainty about whether:
 - the Australian Government authorised Airservices Australia to enter into contracts such as the upper airspace management contracts with the Solomon Islands Government; and
 - entering into upper airspace management contracts with other governments means this airspace has become “Australian-administered airspace” for the purposes of the Air Services Act;
- clearly identifying the nature of the relationship that is being established by future international business contracts, and any resulting fiduciary and other duties, so as to ensure its practices and procedures satisfy these requirements;
- prior to entering into future contracts that involve it acting as the collection agent of other governments, taking the necessary steps to identify the

requirements and/or conditions that need to be satisfied when collecting and remitting statutory revenue; and

- consulting with the Solomon Islands Government so as to ensure that the manner in which Airservices Australia is paid for managing the upper airspace fully complies with the Solomon Islands Constitution.

Entity responses

38. The following entities provided formal comments on the proposed report of this performance audit.

Airservices Australia

Airservices Australia accepts the recommendations of the audit report and is committed to their swift implementation.

Airservices further accepts that its internal processes at the time third party payments were made were inadequate. The organisation identified third party payments as an issue in September 2003 and stopped the practice. Corporate governance procedures have been significantly improved since that time, and particularly so in more recent times as part of an organisation 'remake' and the focus on a series of business improvement programs. The implementation of the audit recommendations will further strengthen procedures.

Airservices maintains it did assess its legal capacity to perform the services under its enabling legislation at the time it entered the contract.

Airservices acknowledges that it did not assess the nature of the relationship arising from revenue collection and repatriation obligations under the SIG Constitution.

Airservices maintains that, while the organisation's commercial arrangements in the Solomon Islands had no impact on the performance of its domestic public purpose responsibility to deliver safe and efficient air navigation services in Australian airspace, it acknowledges it had a broader public purpose obligation.

DOTARS

The Department of Transport and Regional Services' response to the ANAO's proposed report addresses Recommendation No.1 of the proposed report.

The Department of Transport and Regional Services and Airservices Australia have reached a shared understanding that as at the date of formation of the first contract in 1998, Airservices was empowered to enter into the contract

and it was therefore not necessary that Solomon Islands airspace become “Australian administered airspace”.

For the airspace of another country to become “Australian administered airspace” would require an arrangement between the government of that country and the Australian Government. No approach was made by the Government of the Solomon Islands directly to the Australian Government in this regard.

In the absence of some express agreement, the Department considers that the contract was a commercial arrangement for Airservices to assist the Solomon Islands in the administration by the Solomon Islands of its airspace.

Similar contracts entered into by Airservices Australian in the future cannot be taken as Australian administered airspace unless the Australian Government specifically authorises Airservices Australia to act as agent on its behalf for this purpose.

Solomon Islands Auditor-General

Thank you for the opportunity to view this extract prior to finalisation. I would like to commend you on the Report as it is of high quality and accurately reflects the many issues that emerged during these contractual arrangements. Many complementary matters will be raised in my forthcoming Report to the Solomon Islands Parliament.

Recommendations

Recommendation No.1
Paragraph 2.35 ANAO *recommends* that the Department of Transport and Regional Services and Airservices Australia develop and implement a shared understanding of:

- (a) the extent to, and process by, which Airservices Australia is able to agree to requests from other countries that it administer airspace allocated to those countries under the Chicago Convention on International Civil Aviation; and
- (b) whether agreeing to requests to manage airspace under contract makes that airspace “Australian-administered airspace” for the purposes of the Air Services Act.

Agreed: DOTARS and Airservices Australia

Recommendation No.2
Paragraph 3.36 ANAO *recommends* that, prior to entering into future international business contracts, Airservices Australia clearly identify the nature of the relationship that is being established by the contract, and any resulting fiduciary and other duties, and ensure its practices and procedures satisfy these requirements.

Agreed: Airservices Australia

Recommendation No.3
Paragraph 4.54 ANAO *recommends* that, prior to entering into future contracts that involve it acting as the collection agent of other governments, Airservices Australia take the necessary steps to identify the requirements and/or conditions that need to be satisfied when collecting and remitting statutory revenue.

Agreed: Airservices Australia

Recommendation No.4
Paragraph 4.62 ANAO *recommends* that Airservices Australia consult with the Solomon Islands Government so as to ensure that the manner in which it is paid for managing the upper airspace in the Honiara Flight Information Region fully complies with the requirements of the Solomon Islands Constitution.

Agreed: Airservices Australia

Audit Findings and Conclusions

1. Introduction

This chapter provides background information on Airservices Australia and its upper airspace management contracts with the Solomon Islands Government, outlines the request for this audit and explains the audit approach.

Background

1.1 Prior to July 1995, Australian air safety regulatory and service provider functions were provided by one entity, the Civil Aviation Authority. The *Civil Aviation Legislation Amendment Act 1995* and the *Air Services Act 1995* (Air Services Act) created, respectively, the Civil Aviation Safety Authority (CASA) and Airservices Australia. The separation of the regulatory and service provider functions was intended to provide a clearer focus on aviation safety regulation, and ensure that there was no conflict with the more commercial goals of the service provider (Airservices Australia).⁷

1.2 Airservices Australia's legislated functions include airspace management, air traffic flow management, air traffic control services, flight information and aviation rescue and fire fighting services. Its airspace management role is carried out in accordance with the Chicago Convention on International Civil Aviation, to which Australia is a contracting state. It has twice been recognised by the International Air Transport Association as the world's best air traffic control provider, most recently in 2005.

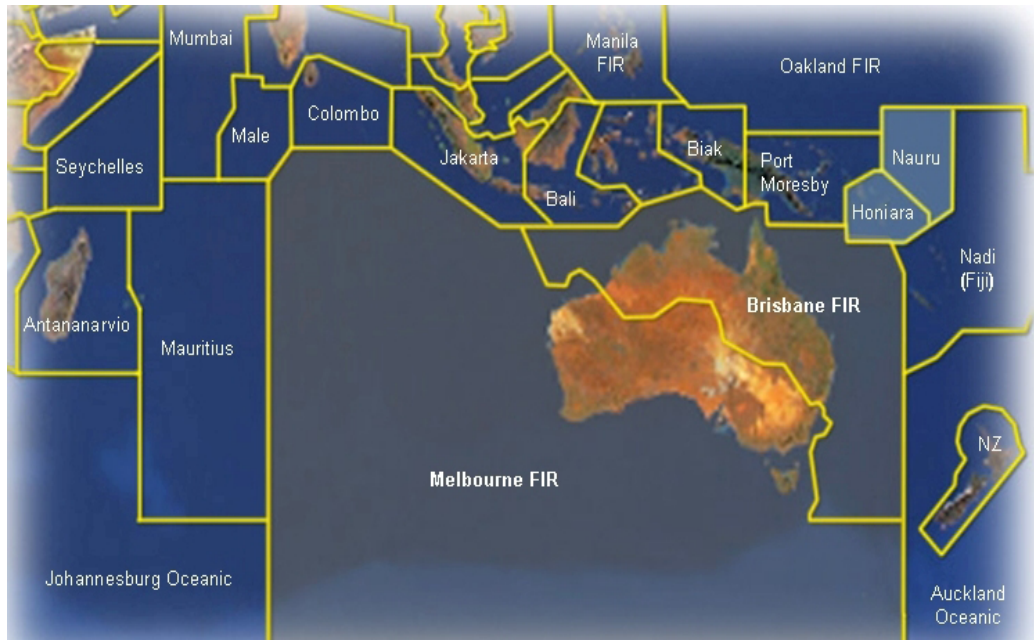
The management of other nations' airspace by Airservices Australia

1.3 The world's airspace is divided into a series of contiguous Flight Information Regions (FIRs) within which air traffic services are provided. Australia has two FIRs, which collectively cover more than 11 per cent of the globe. In this respect, the Melbourne and Brisbane FIRs include Australia's sovereign airspace as well as international airspace over the Pacific, Indian and Southern Oceans (see Figure 1.1).

⁷ Air Services Bill 1995, Second Reading Speech, House of Representatives, 7 June 1995.

Figure 1.1

South East Asia and Indian Ocean Airspace



Source: Airservices Australia

1.4 Airservices Australia is the Australian airspace authority. Accordingly, it manages the Melbourne and Brisbane FIRs. In addition, Airservices Australia has entered into contracts to manage the upper airspace in the Honiara and Nauru FIRs (see Figure 1.1 above). These FIRs do not involve high traffic levels. Accordingly, the amount of revenue earned under the contracts represents less than two per cent of Airservices Australia’s total commercial revenue.⁸

⁸ In relation to the Nauru contract, the November 2005 report of an Airservices Australia internal audit noted that sufficient revenue had not been generated to pay the Airservices Australia contract management fee.

Overview of the upper airspace management contracts with the Solomon Islands Government

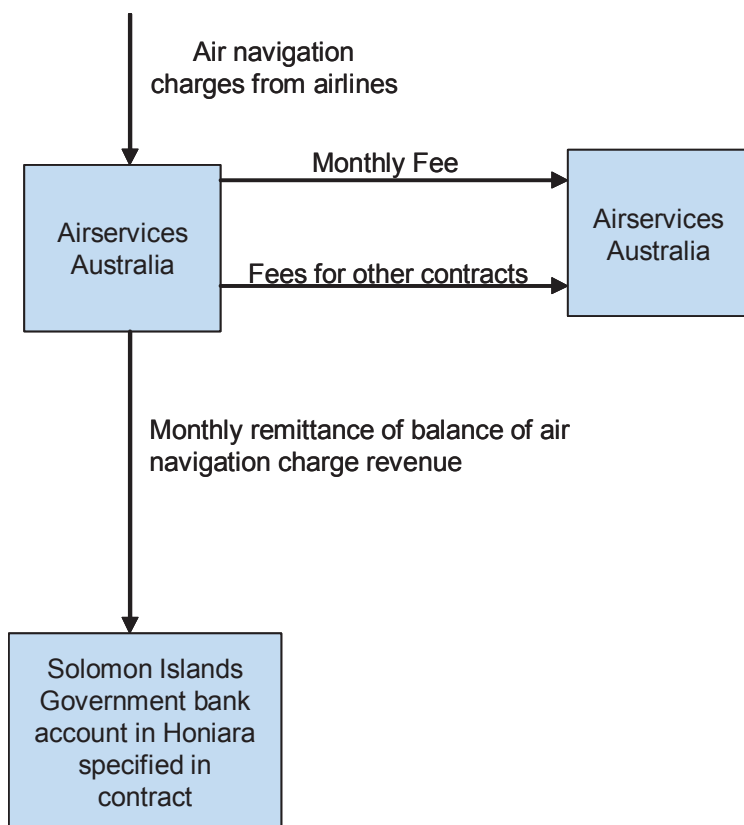
1.5 There have been two upper airspace management contracts with the Solomon Islands Government. The first was made on 27 April 1998. It ran for five years, commencing on 1 June 1998. A second contract was made on 21 May 2003, to run for a further ten years. The terms of the second contract were substantially similar to the original 1998 contract.

1.6 The upper airspace management contracts have involved two distinct but related services:

- manage the upper airspace in the Honiara FIR; and
- collect air navigation fees from aircraft flying through the FIR, deduct the amount of Airservices Australia's monthly fee from the air navigation fees collected, and remit the remaining funds to a specified Solomon Islands Government bank account in Honiara (except when Airservices Australia and the Solomon Islands Government agreed that the funds be used to pay for other goods and services provided by Airservices Australia under another contract with the Solomon Islands Government). Figure 1.2 summarises this aspect of the contract.

Figure 1.2

Contractual arrangements for Airservices Australia’s collection and remittance of Solomon Islands Government air navigation fee revenue



Source: ANAO analysis of the upper airspace management contracts with the Solomon Islands Government

Solomon Islands Auditor-General’s review

1.7 Concerns were first raised about the use of air navigation fee revenue in June 2001, as a result of allegations published in the Solomon Islands that Solomon Islands officials had been misusing the revenue. Airservices Australia concluded that its contractual arrangements remained suitable and payments continued to be made to third parties at the request of Solomon Islands Government Ministers and officials.

1.8 In 2003, two internal reviews of the management of the upper airspace management contracts were undertaken. As a result of these reviews, payments outside the terms of the written contracts were discontinued.

1.9 In April 2005, Airservices Australia was advised by the Office of the Solomon Islands Auditor-General that it had been asked by the Solomon Islands Government Accountant-General to undertake a review of financial transactions resulting from proceeds collected by Airservices Australia under the upper airspace management contracts. Airservices Australia was asked to provide certain information to assist with this review.⁹ Over the period 20 to 24 June 2005, a two person team from the Office of the Solomon Islands Auditor-General visited Airservices Australia to obtain certain documents, including bank statements.¹⁰

1.10 In June 2005, another internal audit was initiated. This was a direct result of the June 2005 visit to Airservices Australia by the Office of the Solomon Islands Auditor-General. The report of this third internal audit was finalised in November 2005.

1.11 Airservices Australia has provided two briefs to the then Minister for Transport and Regional Services on the Solomon Islands Government Auditor-General's draft report.

1.12 The first briefing was provided on 15 March 2006. Its purpose was to advise the then Minister of a review of civil aviation (including payments made by Airservices Australia from air navigation fee revenue collected on behalf of the Solomon Islands Government) being undertaken by the Solomon Islands Auditor-General and outline Airservices Australia's strategy for dealing with the issues that could result once the report becomes public.

1.13 A second briefing was provided to the Minister on 28 April 2006.¹¹ Its purpose was to inform the Minister of the contents of the extracts of the draft report received from the Solomon Islands Auditor-General. Airservices Australia also outlined its response to the draft report and advised of its strategy to deal with the issue.

⁹ Specifically, Airservices was asked to provide a copy of the first contract along with a schedule of all receipts to, and payments from, the bank account into which the air navigation fees were deposited by Airservices Australia.

¹⁰ The Solomon Islands audit team was unable to obtain all the information sought in the time available. At their request, Airservices Australia provided evidence to support further transactions that spanned the period of the contract.

¹¹ In April 2006, Airservices Australia had been provided with extracts of the draft report of the Solomon Islands Auditor-General. In May 2006, Airservices Australia provided comments on the draft extracts to the Office of the Solomon Islands Auditor-General. The Solomon Islands Auditor-General tabled his report in the Solomon Islands Parliament in October 2006.

1.14 On 3 May 2006, the Minister was briefed by the Department of Transport and Regional Services (DOTARS) on this matter. After considering this brief, the Minister indicated to DOTARS that he considered there needed to be an external review by the Australian Auditor-General of Airservices Australia's role and handling of the issues.

Minister's request for an ANAO performance audit

1.15 On 5 May 2006, the then Minister for Transport and Regional Services wrote to the Auditor-General requesting that consideration be given to undertaking a performance audit of the administration by Airservices Australia of its contracts with the Solomon Islands Government for upper airspace management. The Minister's letter indicated that:

- he had been advised by the DOTARS that, as part of a broader audit of civil aviation, the Solomon Islands Auditor-General had examined the administration by Airservices Australia of its contracts for the management of upper airspace;
- while the focus of the Solomon Islands Auditor-General's report is on the actions of Solomon Islands Government officials, the Minister had been advised that the draft report identified irregularities in the administration of the contract;
- particular reference was made to payments by Airservices Australia to third parties of up to \$2.5 million in the period 1998-2003¹²; and
- these payments were made by Airservices Australia at the request of authorised Solomon Islands Government civil aviation officials and ceased in late 2003, following an internal review by Airservices Australia.

1.16 On 9 May 2006, the Auditor-General advised the Minister that he would undertake a performance audit and that the specific audit objectives and approach would be established once officers of the Australian National Audit Office (ANAO) had the opportunity to undertake preliminary enquiries with senior staff in Airservices Australia and DOTARS.

¹² The Solomon Islands Auditor-General advised ANAO in September 2006 that although the draft report indicated \$2.5 million, the final report to the Solomon Islands Parliament will specify \$2.2 million as the payments by Airservices Australia to third parties.

Audit approach

1.17 On 31 May 2006, the Auditor-General designated a performance audit under section 18 of the *Auditor-General Act 1997* (Auditor-General Act). The objectives of the performance audit were to:

- examine the development and administration by Airservices Australia of its contracts with the Solomon Islands Government for upper airspace management;
- assess the regularity of payments made under the contracts and steps taken by Airservices Australia in respect of any irregularities; and
- make recommendations for any improvements in the processes employed by Airservices Australia in developing and administering these and similar contractual arrangements.

Audit scope

1.18 The request for this audit to be undertaken arose from concerns in relation to the remittance of funds to the Solomon Islands Government. Accordingly, ANAO did not seek to assess the efficiency and effectiveness of the air traffic management services provided by Airservices Australia.

1.19 Instead, having regard to the concerns raised by the then Minister for Transport and Regional Services, ANAO's examination of Airservices Australia's contract management focused on the development and negotiation of the contracts and the repatriation of the air navigation fee revenue to the Solomon Islands Government. This latter aspect included examining the regularity of payments made by Airservices Australia from the air navigation fees collected.

1.20 The audit did not assess the administration by Solomon Islands Government agencies or Ministers of the upper airspace management contracts with Airservices Australia. In this respect, there is an ongoing review of civil aviation being conducted by the Solomon Islands Auditor-General. This review includes examination of the financial transactions resulting from air navigation fee revenue collected by Airservices Australia under the upper airspace management contracts.

Audit methodology

1.21 The audit approach included:

- examining the development and administration of the upper airspace management contracts signed in 1998 and 2003 between Airservices Australia and the Solomon Islands Government, together with the amendments to those contracts, in the context of Airservices Australia's stated mission;
- examining relevant files and supporting documentation held by Airservices Australia and DOTARS, including in relation to financial transactions undertaken with the air navigation fees collected on behalf of the Solomon Islands Government;
- identifying the steps taken by Airservices Australia to respond to the matters of concern that arose from payments made under the contracts;
- interviewing key officers involved in the development and administration of the contracts and the executive management of Airservices Australia; and
- travelling to the Solomon Islands to meet with: the Auditor-General for the Solomon Islands and his staff; staff of the Solomon Islands Accountant-General; the Permanent Secretary of the Solomon Islands Department of Communication, Aviation and Meteorology; and the Australian High Commissioner to the Solomon Islands.

1.22 Audit fieldwork was conducted between June 2006 and August 2006. In accordance with Section 19 of the Auditor-General Act, a proposed report was issued on 31 August 2006 to the then Minister for Transport and Regional Services, DOTARS, Airservices Australia and former employees of Airservices Australia that were directly involved in the negotiation and management of the upper airspace management contracts. Relevant extracts were provided to the Solomon Islands Auditor-General, the Solomon Islands Accountant-General and the Civil Aviation Division of the Solomon Islands Government.

1.23 The audit was conducted in accordance with ANAO Auditing Standards, at a cost to the ANAO of \$270 000.

2. Governance arrangements

This chapter provides an overview of the Airservices Australia governance arrangements applying to the development and administration of the upper airspace management contracts with the Solomon Islands Government.

Background

2.1 Statutory authorities are established to undertake functions of government or provide services to the community on behalf of government.¹³ Under the *Commonwealth Authorities and Companies Act 1997* (CAC Act), Airservices Australia is a Commonwealth statutory authority incorporated for a public purpose by an Act of the Australian Parliament (the Air Services Act).

2.2 Airservices Australia was initially established as a Government Business Enterprise (GBE). However, in 1997, it ceased to be classified as a GBE. Airservices Australia has stated on a number of occasions¹⁴ that securing the status and enhanced business opportunities of a GBE remains a high priority for the organisation.¹⁵

2.3 Airservices Australia has a range of statutory functions, which are set out in section 8 of the Air Services Act. In addition, section 9 of the Air Services Act provides that:

- when exercising its powers and performing its functions, Airservices Australia must regard the safety of air navigation as the most important consideration; and
- subject to this first requirement, Airservices Australia must exercise its powers and perform its functions in a manner that ensures that, as far as possible, the environment is protected from the effects of the operation and use of aircraft.

2.4 In August 1997, the Government issued a document entitled *Governance Arrangements for Airservices Australia*. This document addresses reporting by

¹³ *Review of the Corporate Governance of Statutory Authorities and Office Holders*, John Uhrig, June 2003, p. 30.

¹⁴ See, for example, *Airservices Australia Annual Report July 2004—June 2005*, p. 8.

¹⁵ Since the commencement of the CAC Act on 1 January 1998, a GBE is a Commonwealth authority or company that is prescribed under the regulations to the CAC Act.

Airservices Australia (corporate plans, six-monthly progress reports, reports on operations and financial statements and keeping the Minister informed), the Board of Directors, financial governance and a range of other governance matters.

2.5 In 1999, the Government agreed that the Minister for Transport and Regional Services and the Minister for Finance and Administration set a date for the incorporation of Airservices Australia under the *Corporations Act 1989*.¹⁶ In September 2003, an Inter-Departmental Committee was established¹⁷ to examine the implementation of new governance arrangements for Airservices Australia. The report of the Inter-Departmental Committee examined the issues associated with incorporating Airservices Australia. It also made recommendations on the steps that should be taken to incorporate Airservices Australia and transfer regulatory functions to ensure a clear separation between the role of airspace regulator and commercial service provider.

2.6 On 1 April 2004, the Government announced¹⁸ that the airspace regulatory function would be transferred to an Airspace Directorate within DOTARS. The Government further announced that, until enabling legislation for this change was introduced, Airservices Australia would continue to perform the airspace regulatory function, but that internal procedures would be established to ensure a clear separation between regulatory activities and operational air traffic control activities. Other important aspects of the Government decision were that:

- action to incorporate Airservices Australia under the Corporations Act would be deferred until the separate regulatory authority was established; and
- in order to improve its focus, performance and accountability, Airservices Australia would be prescribed as a GBE, with its operations as a GBE to commence as soon as the Minister for Finance and

¹⁶ From 15 July 2001, the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001*, together with various other acts, created a national framework of corporate regulation in Australia replacing the previous national scheme in existence since 1 January 1991.

¹⁷ The Inter-Departmental Committee comprised officers from DOTARS together with the Departments of Finance and Administration, the Treasury, the Prime Minister and Cabinet, Defence and Employment and Workplace Relations.

¹⁸ The Hon John Anderson MP, Deputy Prime Minister and Minister for Transport and Regional Services, Media Release A45/2004 and Senator Nick Minchin, Minister for Finance and Administration, *Changes to Airspace Regulation in Australia*, 1 April 2004.

Administration was satisfied that Airservices Australia had fully established its separate airspace regulatory function.

2.7 On 14 September 2006, the then Minister for Transport and Regional Services announced a number of key reforms to the governance and management of Australian airspace.¹⁹ These reforms included the transfer of airspace classification and designation functions from Airservices Australia to CASA with these airspace regulatory functions to be performed within CASA by a dedicated unit called the Office of Airspace Regulation. The then Minister also announced that Uhrig assessments of Airservices Australia and CASA had been completed and that there would be no changes in the governance arrangements for Airservices Australia.

Recent organisational restructure and reform

2.8 Airservices Australia advised ANAO in July 2006 that contract administration for all commercial projects, including the upper airspace management contracts, is now provided by its Finance Group. More broadly, in July 2006, the Chief Executive Officer of Airservices Australia advised ANAO of recent changes in Airservices Australia's governance arrangements, as follows.

The Board, and many of the executive management team, are either new to Airservices or have taken up new roles in the organisation as a result of the recent restructure. Whilst we had already commenced the process of restructuring, building or rebuilding our business systems and improving governance, the Solomon Islands issue has been an important reminder of the value of this 'remake' of the organisation.

The restructure, which was implemented from 1 December last year, is now largely complete and has been designed to flatten out the management of the business, make executive management accountable and key issues more visible, ensure an appropriate segregation of duties and to improve efficiency and reduce costs.

A key feature of the restructure has been the centralization of all finance and human resources accountabilities as well as the centralization of processes like project management and procurement. This has led to greater transparency and close management of the budget and the capital expenditure program.

¹⁹ The Hon Warren Truss MP, Minister for Transport and Regional Services, Media Release 155WT/2006, *Airspace management Reform in Australia*, 14 September 2006.

Concurrent with the restructure, the organisation has been conducting a business improvement program which has focused on key areas such as asset management, strategy and decision making, commercial management, procurement and legal compliance. The outcomes of this work are now reflected in executive role statements.

The 'new' Board brings to Airservices a range of skills that has, in my view, substantially raised the governance 'threshold'. Both the Board and management accept that this has been beneficial to the business. Much of this detailed oversight occurs in the Audit Committee and the Safety and Environment Committee. For instance, the Audit Committee now reviews a very extensive audit program which contains a number of regulatory compliance audits, as well as audits to ensure our new and revised business practices are performing to expectations. Similar oversight is occurring in the work of the Safety and Environment Committee.

We recognise that any widespread reform process like this is only as good as the people involved and, as the restructure has been settling, we have embarked on a comprehensive leadership program for all of our management team. This is resulting in changes to the way decisions are made, how we implement more effective behaviours and teamwork which we hope will, over time, lead to a change in the culture of this organisation.

In the context of these significant improvements to our business model, the context of the Solomon Islands issue has been disappointing.

Role of the Minister

2.9 Under the Air Services Act,²⁰ the Minister for Transport and Regional Services may:

- direct Airservices Australia to vary its corporate plan (section 14);
- give binding directions to Airservices Australia in relation to the performance of its functions or the exercise of its powers (section 16);
- notify Airservices Australia of the Minister's views on the appropriate strategic direction or the manner in which Airservices Australia should perform its functions (section 17); and

²⁰ The Minister also has the following powers under the CAC Act:

- to request reports, documents and information from Airservices on its operations and the operations of its subsidiaries (section 16); and
- to notify Directors of general Government policies that are to apply to Airservices (section 28).

- direct Airservices Australia to give a specified Ministerial nominee any documents or information relating to Airservices Australia's operations that the nominee requests (section 18).

2.10 The practice has been for the Minister to issue Charter Letters to Airservices Australia. These Charter Letters are not legally binding on Airservices Australia but there is an expectation that the authority will act in accordance with them.²¹

2.11 The June 2003 report of the Uhrig Review of the Corporate Governance of Statutory Authorities and Office Holders²² recommended that expectations of statutory authorities be clarified by:

- Ministers issuing Statements of Expectations to authorities;
- statutory authorities responding with Statements of Intent for approval by Ministers; and
- Ministers making public those Statement of Expectations and Intent.

2.12 The Australian Government's August 2004 response to the report endorsed this recommendation. Airservices Australia has stated that it expects the Minister for Transport and Regional Services will, in the future, issue it with a Statement of Expectations that will be similar in style to a Charter Letter.²³

Airservices Australia's commercial activities

2.13 Airservices Australia's stated mission is 'to be the preferred global partner for air traffic and related aviation services'.²⁴ As part of its corporate strategy, Airservices Australia aims to:²⁵

- expand its customer and product/service base to grow and diversify revenues; and

²¹ Airservices Australia, *Board Governance Manual*, 2006, p.6.

²² *Review of the Corporate Governance of Statutory Authorities and Office Holders*, John Uhrig, June 2003, p. 11.

²³ Airservices Australia, *Board Governance Manual*, 2006, p.6.

²⁴ Airservices Australia, *Corporate Plan July 2005 – June 2010*, p. 1.

²⁵ *ibid.*

- be the preferred regional supplier of air traffic management and related services, jointly servicing with its partners the southern hemisphere airspace over the long term.

2.14 International markets are seen by Airservices Australia as providing the greatest opportunity for significant growth in other commercial revenue.²⁶ Currently, South East Asia, Northern Asia and the Indian Sub Continent are seen as the most attractive geographic growth markets due to their proximity to Australia, strong airport development prospects and underdeveloped air traffic management environment.²⁷

2.15 In pursuing commercial business opportunities, Airservices Australia seeks to leverage off its core capabilities in air traffic management, aviation fire and rescue services and associated system development, management and maintenance. In its 2004–05 Annual Report,²⁸ Airservices Australia stated that:

Complementing our major contract with the FAA²⁹ and our 10-year contract to provide upper level airspace management on behalf of the Solomon Islands, 2004–05 saw increased activity on several multimillion dollar international projects. As a result we were able to generate some \$29.3 million in other commercial revenue.

2.16 Table 2.1 below summarises the revenue projections included in Airservices Australia's current corporate plan. Of significance is that Airservices Australia projects that other commercial revenue will progressively increase from less than 5 per cent in 2004–05 to almost 10 per cent in 2009–10.

²⁶ Airservices Australia, *Corporate Plan July 2005 – June 2010*, p. 32.

²⁷ *ibid.*

²⁸ *op. cit.*, p. 6.

²⁹ Elsewhere in the Annual Report, Airservices Australia reported that its major operational initiatives included, commencing from 1 January 2005, the delivery of a multi-million dollar contract between its United States subsidiary, Airservices Pacific Incorporated, and the United States Federal Aviation Administration (FAA). This was reported to be a five year contract under which Airservices Australia would provide air traffic control services at five tower locations in Hawaii, Guam and Saipan.

Table 2.1**Projected Revenue Sources: 2004–05 to 2009–10 (\$'000)**

Category	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Airways revenue	609 049	651 018	678 896	711 950	735 088	763 269
Gov't contribution	7,000	Nil	Nil	Nil	Nil	Nil
Other commercial revenue	29 200	43 678	60 352	67 444	75 017	82 821
Total revenue	645 249	694 696	739 248	779 394	810 105	846 090

Source: Airservices Australia Corporate Plan July 2005 – June 2010

Legislative restrictions on Airservices Australia's commercial activities

2.17 As a statutory authority, Airservices Australia relies on the powers conferred on it by its enabling legislation in seeking to earn commercial revenue.³⁰ In September 2006, Airservices Australia advised ANAO that, at the time the first contract was signed, it had satisfied itself that it had the legislative power under the Air Services Act to perform the services.³¹ However, any analysis underpinning this conclusion was not documented by Airservices Australia.³²

2.18 In March 2002, Airservices Australia obtained general legal advice on its capacity to enter into commercial ventures in pursuing the Government's requirement that it 'take up export and local development opportunities where they are consistent with its core business'.³³ The advice concluded as follows:

³⁰ In this respect, statutory authorities do not have the same breadth of executive power as Ministers and their Departments (in reliance on sections 61 and 64 of the Constitution, which confer the executive power of the Commonwealth on Ministers).

³¹ Both the 1998 and 2003 contracts included the following warranty (at clause 5.1):

'Each party warrants to the other that:

- (1) it has full power and authority to execute this Agreement and to lawfully perform and observe all the terms and conditions of the Agreement; and
- (2) all actions necessary for the authorisation, execution and performance of this Agreement have been duly taken.'

³² Airservices Australia did, however, obtain written legal advice on the ability of the Solomon Islands Government to contract with Airservices Australia for the management of upper airspace in the Honiara FIR.

³³ Charter Letter provided to Airservices Australia by the then Minister for Transport and Regional Services on 25 October 1999.

Airservices Australia does not have any general function of engaging in commercial activities. Nevertheless, its specified functions would permit it to engage in some commercial activities provided that they fell within one or more of its specific listed functions.

2.19 At its March 2002 meeting, the Airservices Australia Board requested management to pursue legislative change to broaden the authority's ability to grow business.

2.20 In advising the Australian Government on Airservices Australia's request for legislative change, DOTARS also obtained legal advice regarding Airservices Australia's legislated functions. The advice was obtained in April 2003. However, it was not formal, settled advice. This was mainly because Airservices Australia declined to provide DOTARS with details of the activities it had been unable to undertake under the terms of the Air Services Act, or a copy of the March 2002 legal advice. DOTARS' legal advice concluded that:

The terms of section 8 [of the *Air Services Act*] mean that each instance of commercial activity in which Airservices Australia wishes to engage needs to be tested against the terms of the Act to ensure that Airservices Australia may engage in it. While section 8 in its current form does allow Airservices Australia to engage in quite a broad range of commercial activity, there are limits and grey areas where much will depend on the particular proposed activity and surrounding circumstances.

2.21 Amendments to the Air Services Act were included in the *Civil Aviation Legislation Amendment Act 2003* to expand the scope of Airservices Australia's statutory functions so that it may pursue additional commercial opportunities overseas and in Australia.³⁴ These amendments commenced upon Royal Assent, which was received on 6 September 2003. Accordingly, they did not apply to Airservices Australia's capacity to enter into either of the upper airspace management contracts with the Solomon Islands Government, made on 27 April 1998 and 21 May 2003. Table 2.2 outlines Airservices Australia's legislated functions before and after the 2003 amendments.

³⁴ Supplementary Explanatory Memorandum, Amendments to be Moved on Behalf of the Government, Circulated by authority of the Minister for Transport and Regional Services, the Honourable John Anderson, MP, *Civil Aviation Legislation Amendment Bill 2003*, 27 March 2003, p. 1.

Table 2.2 Legislated functions under Section 8(1) of the Air Services Act 1995

Prior to 6 September 2003	Following 6 September 2003 Amendments
<p>(a) providing facilities to permit safe navigation of aircraft within Australian-administered airspace;</p> <p>(aa) promoting and fostering civil aviation in Australia;</p> <p>(b) providing the following services, for the purpose of giving effect to the Chicago Convention or otherwise for purposes relating to the safety, regularity or efficiency of air navigation:</p> <ul style="list-style-type: none"> (i) air traffic services; (ii) an aeronautical information service; (iii) rescue and fire fighting services; (iv) an aeronautical radio navigation service; (vi) an aeronautical telecommunications service; <p>(c) cooperating with the Bureau of Air Safety Investigation in relation to the investigation of aircraft accidents and incidents;</p> <p>(d) carrying out activities to protect the environment from the effects of, and the effects associated with, the operation of Commonwealth jurisdiction aircraft;</p> <p>(f) any functions conferred on Airservices Australia under the <i>Air Navigation Act 1920</i>;</p> <p>(g) any other functions prescribed by the regulations, being functions relating to any of the matters referred to in this subsection;</p> <p>(i) any functions incidental to any of the above functions.</p>	<p>(a) providing services and facilities:</p> <ul style="list-style-type: none"> (i) for the purpose of Australia or another country giving effect to the Chicago Convention; or (ii) for the purpose of Australia or another country giving effect to another international agreement relating to the safety, regularity or efficiency of air navigation; or (iii) otherwise for purposes relating to the safety, regularity or efficiency of air navigation, whether in or outside Australia; <p>(b) promoting and fostering civil aviation, whether in or outside Australia;</p> <p>(c) cooperating with the Executive Director of Safety Investigation in relation to investigations under the <i>Transport Safety Investigation Act 2003</i> that relate to aircraft;</p> <p>(d) carrying out activities to protect the environment from the effects of, and the effects associated with, the operation of:</p> <ul style="list-style-type: none"> (i) Commonwealth jurisdiction aircraft, whether in or outside Australia; or (ii) other aircraft outside Australia; <p>(e) any functions prescribed by regulations in relation to the effects of, and effects associated with, the operation of:</p> <ul style="list-style-type: none"> (i) Commonwealth jurisdiction aircraft, whether in or outside Australia; or (ii) other aircraft outside Australia; <p>(f) any functions conferred on Airservices Australia under the <i>Air Navigation Act 1920</i>;</p> <p>(g) any other functions prescribed by the regulations, being functions relating to any of the matters referred to in this subsection;</p> <p>(h) providing consultancy services and management services relating to any of the matters referred to in this subsection;</p> <p>(i) any functions incidental to any of the above functions;</p> <p>(j) providing services and facilities, whether or not related to aviation, for a purpose other than one that is mentioned or implied in any of paragraphs (a) to (i), if doing so:</p> <ul style="list-style-type: none"> (i) is within the executive or legislative powers of the Commonwealth; and (ii) utilises Airservices Australia's spare capacity; and (iii) maintains or improves the technical skills of Airservices Australia's employees; and (iv) does not impede Airservices Australia's capacity to perform its other functions.

Source: Air Services Act 1995

Authority to enter into the upper airspace management contracts

2.22 At its March 2002 meeting, the Airservices Australia Board noted that:

- management was developing guidelines based on legal advice against which future new business development proposals would be judged;
- any business development opportunity greater than \$10 million would be referred for external legal validation that Airservices Australia had the power to undertake the work; and
- Airservices Australia was unable to proceed with a particular business opportunity brought before the Board in November 2001.

2.23 However, arrangements that were already in place at the time the March 2002 legal advice was obtained, such as the first upper airspace management contract with the Solomon Islands Government, were not reassessed by Airservices Australia against that legal advice. In addition, as the May 2003 contract was viewed as an extension to an existing arrangement rather than a new business proposal, this contract was also not assessed against the March 2002 legal advice prior to being signed.

2.24 ANAO analysed the upper airspace management contracts with the Solomon Islands Government against Airservices Australia's March 2002 legal advice. This analysis raised issues about whether Airservices Australia was empowered by its enabling legislation to enter into the contracts at the time.

2.25 On 20 July 2006, Airservices Australia obtained legal advice specific to the upper airspace management contracts with the Solomon Islands Government. This advice concluded that the 2003 amendments to the Air Services Act meant that the provision of services in accordance with the upper airspace management contracts with the Solomon Islands Government is now clearly within Airservices Australia's statutory power.

2.26 In terms of Airservices Australia's statutory powers when it entered into the upper airspace management contracts in 1998 and 2003, the advice concluded as follows:

The terms of the Air Services Act 1995 as it stood in April 1998 were adequate to confer on Airservices Australia a function of entering into the Solomon Islands contract and thereby sufficient statutory authority for it to do so.

2.27 Similarly, on 11 August 2006, DOTARS obtained legal advice that concluded as follows:

We think it is clear that, at the time each contract was entered into, Airservices had power to enter into the contracts and provide the services under s.8(1)(b) of the Air Services Act.

2.28 In September 2006, Airservices Australia advised ANAO that it accepts the views of the Australian Government Solicitor on this issue (that is, the advice obtained by DOTARS).

Guidelines for keeping the Minister informed of new external business opportunities

2.29 On 16 September 2003, Airservices Australia wrote to the then Minister for Transport and Regional Services seeking his agreement to a set of draft guidelines concerning Airservices Australia's pursuit of external business opportunities. On 1 April 2004, the then Minister advised the Board that he remained supportive of the Board's efforts to grow its business and take up export and local development opportunities. He further advised that the guidelines, as revised following discussions between DOTARS and Airservices Australia, adequately explain the procedures for Airservices Australia to keep him informed of proposed new business opportunities. Key points in the guidelines to note are that they:

- define significant new business opportunities as those that are in excess of \$15 million in value and/or are sensitive in nature, and thus of interest to the Minister regardless of financial magnitude;
- require Airservices Australia to keep DOTARS informed of upcoming opportunities that may trigger application of the guidelines as well as progress on pursuing opportunities where the guidelines have been applied; and
- require Airservices Australia to notify the Minister of any proposal to pursue a significant business opportunity within Australia or overseas, including those identified in section 15(1) of the CAC Act.³⁵

³⁵ Section 15(1) of the CAC Act requires the directors of a Commonwealth authority (or any of its subsidiaries) to immediately give the responsible Minister written particulars of any proposal to:

- form a company or participate in the formation of a company;
- participate in a significant partnership, trust, unincorporated joint venture or similar arrangement;
- acquire or dispose of a significant shareholding in a company;
- acquire or dispose of a significant business;
- commence or cease a significant business activity;
- make a significant change in the nature or extent of its interest in a significant partnership, trust, unincorporated joint venture or similar arrangement.

2.30 Similar guidelines were not in place prior to Airservices Australia entering into either of the upper airspace management contracts with the Solomon Islands Government.

Australian-administered airspace

2.31 Section 3 of the Air Services Act defines Australian-administered airspace as:

- the airspace over Australian territory;
- airspace that has been allocated to Australia by the International Civil Aviation Organization (ICAO) under the Chicago Convention and for which Australia has accepted responsibility; and
- airspace administered by Australia at the request of another country.

2.32 Airservices Australia has had a strategy to be the major provider of air space management and related services in the southern hemisphere. To date it has had limited success in expanding its upper airspace management activities, with the only airspace management contracts signed being those for the Honiara and Nauru FIRs.³⁶

2.33 As outlined above, both Airservices Australia and DOTARS have, in the course of this performance audit, obtained legal advice that has concluded that Airservices Australia’s enabling legislation empowered it to enter into the upper airspace management contracts with the Solomon Islands Government. However, on the basis of the advice they have received, DOTARS and Airservices Australia hold different views on whether or not:

- the Australian Government authorised Airservices Australia to enter into contracts such as the upper airspace management contracts with the Solomon Islands Government; and
- the Honiara FIR is “Australian-administered airspace”.

2.34 The different perspectives are summarised in Table 2.3. In this respect, the absence of a shared understanding between DOTARS and Airservices Australia on such matters is not conducive to a sound governance framework for Airservices Australia’s international operations. Issues concerning whether

³⁶ In its 2004-05 Annual Report (p.27), Airservices Australia stated that it expected a decision from the Papua New Guinea Government early in 2005-06 on its proposal to manage upper airspace in the Moresby FIR for three years. However, although Airservices Australia was the successful tenderer, the Papua New Guinea Government decided not to contract-out this function.

airspace allocated to other countries under the Chicago Convention but managed by Airservices Australia under contract is “Australian-administered airspace” can also be important for other nations in considering whether to contract with Airservices Australia.³⁷

Table 2.3

Honiara FIR and “Australian-administered airspace”

	DOTARS	Airservices Australia
Australian Government authorisation to enter into the contracts	The Government has not authorised Airservices Australia to enter into the upper airspace management contracts with the Solomon Islands Government. It was, however, not necessary for this to have occurred in order for Airservices Australia to enter into these contracts and provide services under these contracts.	On the basis that the then Minister responsible for Airservices Australia had not instructed Airservices Australia to refrain from entering into the first upper airspace management contract, it was reasonable for Airservices Australia to infer that: <ul style="list-style-type: none"> it had been authorised by the Australian Government to enter into contracts such as the Solomon Islands contract; and for that purpose, it was further authorised to accede to requests by other countries for their airspace to become “Australian-administered airspace”.
Honiara FIR is “Australian-administered airspace”	This airspace is not “Australian-administered airspace”. The provision of services by Airservices Australia does not require that the relevant airspace is “Australian-administered airspace”.	

Source: ANAO analysis of DOTARS and Airservices Australia advice and documentation

Recommendation No.1

2.35 ANAO recommends that the Department of Transport and Regional Services and Airservices Australia develop and implement a shared understanding of:

- (a) the extent to, and process by, which Airservices Australia is able to agree to requests from other countries that it administer airspace allocated to those countries under the Chicago Convention on International Civil Aviation; and
- (b) whether agreeing to requests to manage airspace under contract makes that airspace “Australian-administered airspace” for the purposes of the Air Services Act.

³⁷ For example, Airservices Australia advised the Department of Foreign Affairs and Trade in December 2005 that it had been unsuccessful in contracting to manage the upper airspace in the Moresby FIR due to significant pressure within Papua New Guinea over the issue of that country’s sovereign airspace.

2.36 DOTARS and Airservices Australia both agreed to the recommendation. Airservices Australia advised ANAO that it met with DOTARS on 6 September 2006 and confirmed each agency has a common understanding of the issues raised by the ANAO. Airservices Australia further commented that it has the authority under its Act to enter into contracts with sovereign nations to manage their airspace, without the requirement for it to be classified as ‘Australian Administered Airspace’.

2.37 For its part, DOTARS commented as follows:

Upon receiving the proposed report, the Department undertook discussions with Airservices with regard to the ANAO’s recommendation. The Department can report that a shared understanding has been reached with Airservices. The key points agreed are as follows:

- As at the date of formation of the first contract to administer upper airspace in the Solomon Islands in 1998, Airservices was empowered by its Act to enter into the contract and it was not necessary that Solomon Islands airspace become “Australian administered airspace” for this purpose.
- For the airspace of another country to become “Australian administered airspace: would require an arrangement between the government of another country and the Australian Government, unless the Australian Government specifically authorises another body to enter into such an arrangement as an agent on its behalf.
- No approach was made by the Government of the Solomon Islands directly to the Australian Government and no authorisation was given to Airservices to act as agent in this regard, and hence the Solomon Islands upper airspace did not become Australian administered airspace.
- Subject to its legislation and statement of expectations, Airservices Australia may enter into commercial arrangements to undertake similar contracts in future but in the absence of any specific authorisation by the Australian Government it is not to be taken that this makes such airspace Australian administered airspace for the purposes of the Air Services Act. Unless specific authorisation is given, such an arrangement would be seen as a contract for services under which Airservices assists the contractor on the administration of the contractor’s airspace.

The Department has also received a further opinion from the Australian Government Solicitor on the issue of Australian administered airspace. This opinion, dated 22 September 2006, has been provided separately to the ANAO.

3. Contract development and management

This chapter examines the development and management by Airservices Australia of its contracts with the Solomon Islands Government for upper airspace management.

Background

3.1 Since at least 1994, Airservices Australia (as the then Civil Aviation Authority) had been investigating whether it would be able to provide air traffic services in the Honiara FIR. In July 1994, as a result of discussions with the Solomon Islands Government, Airservices Australia prepared an internal paper on the feasibility of control of Solomon Islands' upper airspace from Brisbane. This paper concluded that an air traffic control service could be provided using existing resources although there would be a requirement for extra facilities.

3.2 In July 1997, Airservices Australia again raised with the Solomon Islands Government the possibility of managing the upper airspace in the Honiara FIR. The July 1994 feasibility paper was reviewed, with the conclusion that some extra staff would be required to manage upper airspace in the Honiara FIR and that, subject to extra facilities being in place, Airservices Australia would be in a position to assume the airspace within eight to ten weeks of agreement being reached.

3.3 Discussions and meetings with the Solomon Islands Government continued throughout 1997 and into 1998. During this period, Airservices Australia became aware that air traffic service providers from countries such as the United States, New Zealand and Fiji were actively marketing their services within the Pacific. There was a concern within Airservices Australia that, unless it became more active in its marketing efforts, it may not win contracts to provide air traffic services outside of Australia.

3.4 During September 1997, discussions were held in Brisbane between Airservices Australia and Solomon Islands Government officials from the then Ministry of Culture, Tourism and Aviation. Following a visit to the existing Brisbane air traffic services centre and a tour of the new The Australian Advanced Air Traffic System (TAAATS) Centre, the Solomon Islands Government officials sought a formal proposal from Airservices Australia for

management of the upper airspace in the Honiara FIR. Accordingly, a proposal was forwarded to the Solomon Islands Controller of Civil Aviation on 31 October 1997 to form the basis of further discussions.

3.5 On 12 January 1998, the Solomon Islands Government's Civil Aviation Adviser informed Airservices Australia that Government approval had been given to develop detailed plans and timetables together with financial estimates for a proposal that Airservices Australia manage the upper airspace in the Honiara FIR for an initial five year period. Airservices Australia was further advised that approval had been given to seek Airservices Australia's cooperation in developing a broader package, either linked to upper airspace management or standalone, covering a range of associated airspace management issues. The stated aim was to produce a reasonable and financially responsible programme of development for which the Solomon Islands Government would seek funding, including from Australian aid.

Memorandum of Understanding

3.6 Airservices Australia's preferred position was to sign an upper airspace management contract and then discuss the broader package of work the Solomon Islands Government was looking to have undertaken. However, it was important to the Solomon Islands Government that the upper airspace management arrangements be part of the broader package of work. Accordingly, prior to proceeding to finalise and sign the upper airspace management contract, Airservices Australia and the Solomon Islands Government recorded the results of the airspace management discussions in a Memorandum of Understanding (MoU).³⁸

3.7 The MoU stated that Airservices Australia appreciated that the Solomon Islands:

- Is a developing country that currently lacks the funds and skilled personnel necessary to complete the transition to satellite-based airways systems on its own.
- Requires assistance from more technologically developed neighbors in order to successfully undertake the transition.

3.8 In this context, under the MoU, Airservices Australia offered to:

³⁸ The MoU was signed by the then Chief Executive of Airservices Australia on 22 April 1998 and by the Solomon Islands Government on 27 April 1998.

- assist the Civil Aviation Division of the Solomon Islands Government with a five year development plan for civil aviation involving:
 - an upper airspace management service to ICAO standards;
 - management of lower airspace including design of a satellite-based global positioning system airways structure, training in air traffic control and technical assistance in the design of control zones for Henderson Airport in Honiara so as to ensure safe and efficient transfer of aircraft between the air traffic control centre and the upper airspace control centre in Brisbane;
 - training for operational and traffic information services as well as the flight service/air traffic control interface role;
 - seconding an experienced Airservices Australia air traffic control manager to the Solomon Islands for up to 12 months to encompass final acceptance testing and subsequent commissioning of the new control tower at Henderson Airport;
 - updating the Aeronautical Information Publication covering aviation rules and procedures in effect in the Solomon Islands; and
 - setting up a program for Civil Aviation Division officers to gain experience in an Airservices Australia control centre, with a view to becoming self sufficient in the provision of air traffic services in the upper airspace;
- conduct any work undertaken in a manner consistent with Airservices Australia’s commercial charter; and
- include in the program elements of direct assistance, technical advice and staff training combined to maximise the development of airspace management skills in Solomon Islands nationals.

3.9 During negotiations for the first upper airspace management contract, Airservices Australia agreed to undertake the additional subsidiary projects at favourable rates. This was agreed to in order to cement the relationship, as well as recognise the commitment from the Solomon Islands to having Airservices Australia undertake this additional work.

Development of the upper airspace management contracts

3.10 As outlined in Chapter 1, there have been two upper airspace management contracts with the Solomon Islands Government. During the course of the audit, there was no evidence to indicate that payments had been made by Airservices Australia to secure or retain the upper airspace management contracts with the Solomon Islands Government. Table 3.1 summarises the two contracts, and the amendments subsequently made to each.

Table 3.1

Upper Airspace Management Contracts with the Solomon Islands Government as at 30 June 2006

Date signed	Services to be provided	Airservices Australia revenue
Contract 27 April 1998	Manage airspace above Flight Level 245 and collect charges from aircraft	\$42 000 per month or \$504 000 per annum
Variation 23 February 2002	No change	Contract price varied to \$43 000 per month
Variation 21 January 2003	Management of airspace extended to be above Flight Level 150	Payment of \$15 000 lump sum to Airservices Australia
Contract 21 May 2003	Manage airspace above Flight Level 150 and collect charges from aircraft	\$45 000 per month or \$540 000 per annum
Variation 17 August 2004	Revenue repatriation clause varied at request of the Solomon Islands Government to require Airservices Australia to retain all funds until requested to remit them to the specified bank account	No change

Source: ANAO analysis of Airservices Australia documentation and contracts

Development of the first contract

3.11 The draft of the first upper airspace management contract was prepared by Airservices Australia. An initial draft contract was provided to the Solomon Islands Government by Airservices Australia on 2 February 1998. This was a preliminary contract provided for discussion purposes only. It included the body of the contract but the schedules relating to specifics such as the services to be provided, charges and the form of remittance of funds to the Solomon Islands Government had not yet been developed. The Civil Aviation

Division of the Solomon Islands Government referred the draft contract to the office of the Solomon Islands Attorney-General for evaluation.

3.12 A three person team from Airservices Australia visited Honiara between 9 and 13 March 1998. The purpose of this visit was to finalise discussions and negotiate a contract with the Solomon Islands Government that would enable Airservices Australia to manage the upper airspace in the Honiara FIR on a commercial basis. The team comprised:

- the Assistant Manager Industry and Business Development (who became the contract/relationship manager), who was responsible for leading negotiations as well as all financial matters including pricing (in accordance with strategies and pricing options previously agreed within Airservices Australia);
- an officer from Airservices Australia's Office of Legal Counsel, who was responsible for negotiating legal aspects with the Solomon Islands Government Attorney-General's Department; and
- an officer from the Air Traffic Services Group, who was responsible for all air traffic operational issues.

3.13 On 17 March 1998, the then Chief Executive of Airservices Australia was advised that negotiations with the Solomon Islands Government had gone well and were now subject to approval by the Solomon Islands Cabinet, following completion of a number of contract schedules. The then Chief Executive was further advised of the following key terms of the contract:

- a contract period of five years;
- the contract price was fixed but subject to annual escalation; and
- Airservices Australia would collect the air navigation fee revenue in Australian dollars direct from the airlines and repatriate any amounts over and above the Airservices Australia fee back to the Solomon Islands Government.

3.14 A further briefing was provided to the then Chief Executive on 13 April 1998 outlining a summary of plans for the Honiara FIR through the proposed contract. Similar advice was provided to the Airservices Australia Board at its 24 April 1998 meeting.

3.15 The first upper airspace management contract was made on 27 April 1998. It was signed by the then Chief Executive Officer of Airservices Australia

and the then Deputy Prime Minister and Minister for Transport, Works, Communication and Aviation in the Solomon Islands Government.

The 2003 renewal

3.16 The first upper airspace management contract commenced on 1 June 1998 to run for five years, until 31 May 2003. Accordingly, in January 2003, Airservices Australia commenced work towards a new contract with the Solomon Islands Government.

3.17 The first draft of a new contract was finalised by Airservices Australia on 3 February 2003. It was substantially the same as the first contract.

3.18 On 10 February 2003, a visit to the Solomon Islands by the relationship manager was approved. The primary purpose of this visit was to commence the renegotiation of the upper airspace management contract.³⁹ The visit took place between 18 and 25 February 2003. The key changes that were agreed with the Solomon Islands Government involved:

- an agreement period of 120 months (10 years), noting that the draft contract prepared for negotiating purposes by Airservices Australia had proposed an agreement period of 60 months (five years), similar to the first contract;
- a contract price of \$45 000 per month, which was the same as the amount sought by Airservices Australia (a 4.5 per cent increase on the existing amount of \$43 000);⁴⁰ and
- a change to the bank account into which Solomon Islands Government air navigation fee revenue was to be deposited.

3.19 With no further substantive changes, the second contract was signed on 21 May 2003. It was signed by Airservices Australia's Acting Chief Executive Officer and the Controller of Civil Aviation in the Solomon Islands Government.

³⁹ The visit was approved by the General Manager of Air Traffic Management with then Chief Executive Officer and other senior employees copied into the Memorandum seeking approval of the trip.

⁴⁰ The amount of \$42 000 per month specified at the time the 1998 contract was signed was increased by \$1 000 per month in 2002 to reflect extra costs to Airservices Australia.

Organisational arrangements

3.20 A number of areas within Airservices Australia have been involved in the negotiation and management of the upper airspace management contracts with the Solomon Islands Government, as summarised below.

Management of upper airspace

3.21 The operational control of the Honiara upper airspace is delivered from Airservices Australia's Brisbane operations centre using TAAATS. TAAATS was officially commissioned on 1 March 2000⁴¹ at an estimated cost of \$377 million.⁴²

Relationship management

3.22 Until March 2006, overall management of the upper airspace management contract was the responsibility of a business development manager within the Air Traffic Management Group. That manager, who had also led the negotiations that led to the contract, undertook the relationship management role until the Business Development area was restructured in March 2006.⁴³ Under the new structure, a Regional Representative—Indonesia, Papua New Guinea, Malaysia and Pacific was appointed.⁴⁴

Invoicing, debt recovery and remittance of revenue

3.23 In managing the Brisbane and Melbourne FIRs, Airservices Australia invoices the operators/owners of aircraft for air navigation fees on a monthly basis. It also manages its own debt recovery system. This system is known as 'Avcharges'. These same systems are used to invoice and collect Solomon Islands Government air navigation fees. To address issues that had earlier arisen in relation to non-collection of some Solomon Islands Government air

⁴¹ Airservices Australia, *Annual Report 2000*, p. 22.

⁴² Senate Rural and Regional Affairs and Transport Legislation Committee, *Hansard*, 1 December 1999, p. 118.

⁴³ Following the redesign and restructure of the Business Development area, expressions of interest were sought from staff in taking voluntary redundancy. A total of 14 staff, including the officer who managed the relationship with the Solomon Islands, received redundancy payments as a result of the restructure.

⁴⁴ Airservices Australia advised ANAO in July 2006 that, overall, this role is accountable for the establishment of Airservices Australia's commercial business presence and profitable commercial growth within this region. The role of the position is to focus on building relationships and providing technical sales advice in the region that will lead to opportunities for Airservices Australia to deliver technology solutions.

navigation fees,⁴⁵ in March 2000, Airservices Australia issued a document called 'Honiara Avcharge Collection Plan'.

3.24 The former Solomon Islands relationship manager was responsible for arranging for deducting Airservices Australia's management fees from the air navigation fees collected on behalf of the Solomon Islands Government. At various times, the relationship manager also arranged for the payment of funds from the air navigation fees to third parties, and used his corporate credit card for payments of expenses and cash (with subsequent reimbursement from the air navigation fees). All payments and credit card reimbursements were processed by Airservices Australia's finance section.

Legal issues

3.25 Airservices Australia's Office of Legal Counsel was involved in the development and administration of the upper airspace management contracts, and related subsidiary contracts Airservices Australia also entered into with the Solomon Islands Government.⁴⁶ In addition, in June 2001, the Office of Legal Counsel provided advice to the Air Traffic Management Group as to the appropriateness of making payments to third parties from the air navigation fees collected on behalf of the Solomon Islands Government (see Chapter 4 for details of this advice).

3.26 The Office of Legal Counsel was also involved in:

- a 2003 review of the management of the contract by Airservices Australia's Office of Security Risk Management, and in the action that was taken as a consequence of that review;⁴⁷
- dealing with a review of civil aviation (including administration of Airservices Australia's upper airspace management contracts with the Solomon Islands Government) conducted by the Office of the Solomon Islands Auditor-General in 2005 and 2006;

⁴⁵ On a number of occasions during 1999 and 2000, Airservices Australia became aware that its systems were not identifying and invoicing all aircraft flying through the Honiara FIR upper airspace. Airservices Australia took steps to invoice the relevant airlines and recover the amounts involved. A subsequent internal audit of 2000-01 collections undertaken by Airservices Australia on behalf of the Bureau of Meteorology (a meteorology service charge), DOTARS (a noise levy) and the Solomon Islands Government concluded that the processes in place were accurate and adequate.

⁴⁶ All contracts were prepared by the Office of Legal Counsel, either directly or through external advisers contracted to assist with a particular matter.

⁴⁷ One of the files relating to this work was unable to be located for ANAO examination.

- a 2005 internal audit initiated by Airservices Australia as a result of the work of the Solomon Islands Auditor-General; and
- providing advice within Airservices Australia on general issues concerning the administration of the contracts and resulting risk exposures.

The nature of the contractual relationship

3.27 As part of the transition to Airservices Australia managing the upper airspace in the Honiara FIR, the *Air Navigation (Air Traffic Control) Regulations 1998* of the *Civil Aviation Act 1986* were amended by the Solomon Islands Government. The changes:

- provided that air traffic control services in the upper airspace were (from 29 May 1998) under the operational control of Brisbane Control Centre, Airservices Australia;
- increased the air navigation fee payable by owners/operators of aircraft flying through upper airspace of the Honiara FIR;
- specified a revised approach to calculating air navigation fees in the upper airspace (consistent with the approach taken by Airservices Australia in the Australian FIR); and
- specified that Airservices Australia was authorised by contract to collect the air navigation fees for the upper airspace.

3.28 At the time of entering into the upper airspace management contracts, Airservices Australia did not identify and assess the nature of the relationship established by the revenue collection and repatriation elements of the contracts. This shortcoming existed in two respects.

3.29 Firstly, although Airservices Australia negotiated and signed a contract for it to collect statutory revenue of the Solomon Islands Government, it did not seek to identify the requirements and conditions that needed to be satisfied in remitting the air navigation fees to the Solomon Islands Government. Specifically, Airservices Australia did not appreciate that all air navigation fee revenue it was collecting on behalf of the Solomon Islands Government was required to be remitted, without any deductions being made, to the Consolidated Fund of the Solomon Islands Government. This requirement exists to provide the necessary transparency to the Solomon Islands Government of the amount of revenue that is being collected, and the use to which it is put. This issue is examined in detail in Chapter 4 of this report.

3.30 Secondly, in its disclosures and advice to the Australian Government and the Australian Parliament, Airservices Australia did not accurately report on the nature of the relationship established for the collection and remittance of air navigation fee revenue of the Solomon Islands Government. Specifically, between 1998-99 and 2004-05, Airservices Australia's financial statements disclosed the funds held on behalf of the Solomon Islands Government as monies held on trust. Similarly, in various briefings and correspondence, Airservices Australia referred to the Solomon Islands Government funds as being held in a "trust account".

3.31 Strictly, a trust is a legal arrangement involving the holding and management of property by one party (the trustee) for the benefit of another (the beneficiary), or for a charitable or statutory purpose. Monies held in trust by Australian Government entities are subject to trust law and accepted accounting principles for the treatment of public sector monies. Monies held in trust are required to be reported in annual financial statements.

3.32 The ANAO has conducted two audits of the management of trust monies. The first, completed in 2002,⁴⁸ focused on entities subject to the *Financial Management and Accountability Act 1997*. The second audit, completed in 2005,⁴⁹ focused on CAC Act entities. Both audits assessed whether selected Australian Government entities were managing trust monies in accordance with legal and administrative requirements and better practice principles. The audit highlighted, amongst other things, the need for:

- entities to obtain legal advice where there is any uncertainty as to the classification of monies reported as trusts;
- policy and procedures that include the duties of trustees; and
- a review of existing controls to ensure that all requirements of managing trusts are properly discharged.

3.33 In June 2006, Airservices Australia obtained external advice on legal issues associated with payments made by it in relation to the upper airspace management contracts. Among other things, this advice concluded that:

⁴⁸ Australian National Audit Office, Audit Report No. 18, 2002-2003, *Management of Trust Monies*, November 2002.

⁴⁹ Australian National Audit Office, Audit Report No. 46, 2004-2005, *Management of Trust Monies in CAC Act Entities*, May 2005.

In the present circumstances, the better view is that there was no intention between the parties for a trust to be created and therefore, it is likely that Airservices is agent for the Solomon Islands Government.

3.34 In terms of past disclosures that the Solomon Islands Government funds were held on trust, Airservices Australia:

- on 5 June 2006, clarified previous Ministerial briefings by advising the Chief of Staff of the Minister for Transport and Regional Services that the account to which airline revenue collected on behalf of the Solomon Islands Government is deposited is a normal bank account and does not carry the obligations of a trust account; and
- in its 2005–06 financial statements, disclosed that funds were being held on behalf of third parties (the Solomon Islands Civil Aviation Authority and the Republic of Nauru), rather than on trust.

3.35 As noted above, Airservices Australia’s June 2006 external legal advice concluded that there is an agency relationship between the Solomon Islands Government (as principal) and Airservices Australia (as agent). Accordingly, although the Solomon Islands Government funds are not held on trust, as its collection agent Airservices Australia owes the Solomon Islands Government particular duties, including:

- the duty to exercise due care and diligence in execution of its role as agent;
- fiduciary duties including acting in the interests of the principal, avoiding conflicts of interest and not using its position for its own gain or benefit; and
- the duty to keep proper and full accounts of all transactions.

Recommendation No.2

3.36 ANAO *recommends* that, prior to entering into future international business contracts, Airservices Australia clearly identify the nature of the relationship that is being established by the contract, and any resulting fiduciary and other duties, and ensure its practices and procedures satisfy these requirements.

3.37 Airservices Australia agreed to the recommendation and advised ANAO that its internal procedures have been amended accordingly.

4. Regularity of payments

This chapter assesses the regularity of payments made by Airservices Australia from Solomon Islands air navigation fees, and steps taken by Airservices Australia in respect of identified irregularities.

Introduction

4.1 The upper airspace management contracts explicitly provided for three types of payments to be made from the air navigation fee revenue collected on behalf of the Solomon Islands Government by Airservices Australia:

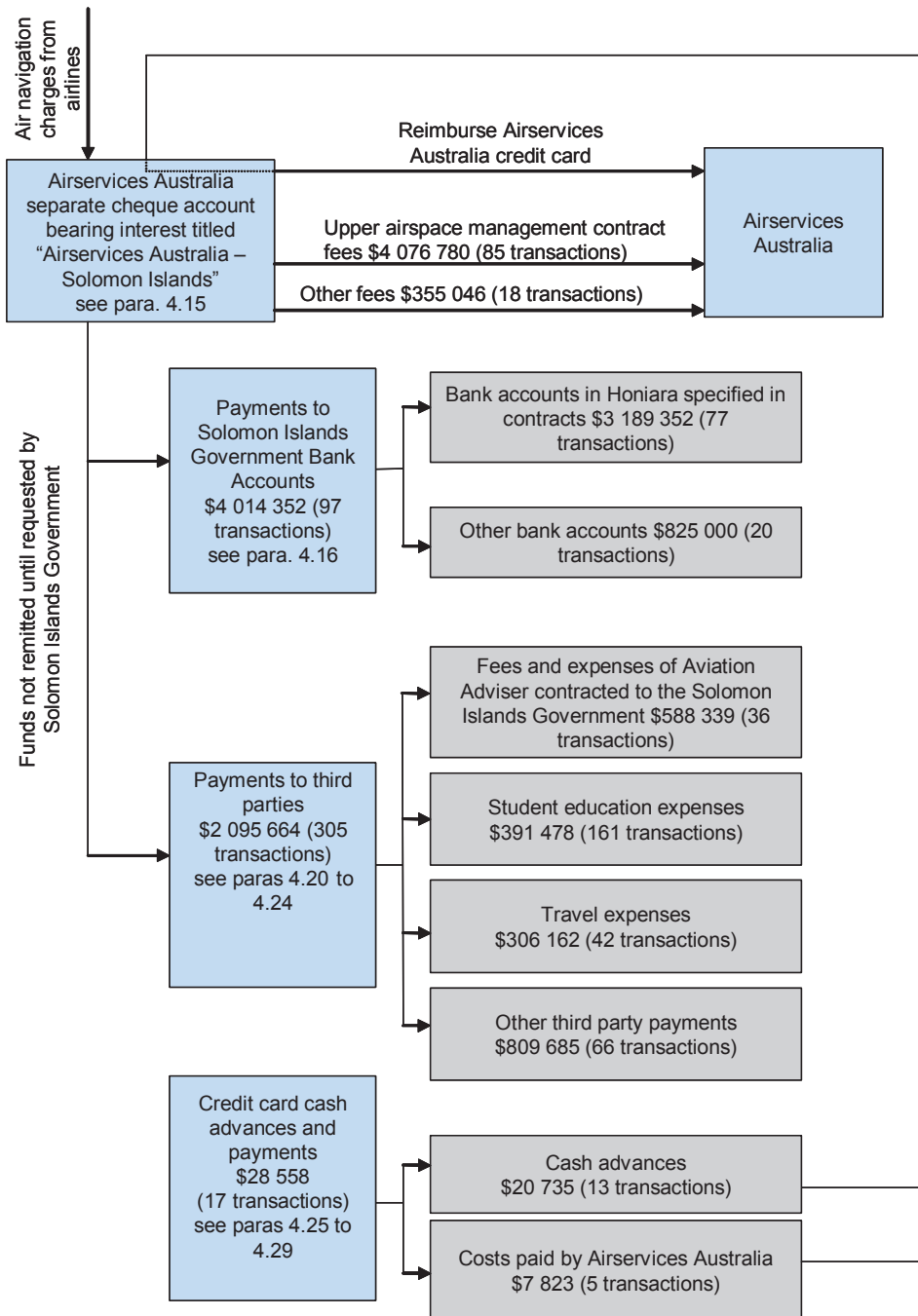
- payments to Airservices Australia of its monthly fee for managing the upper airspace in the Honiara FIR;
- payments to Airservices Australia for goods and/or services provided to the Solomon Islands Government under other contracts; and
- payment of the balance of the funds to a specified Solomon Islands Government bank account.

4.2 After the first contract commenced on 1 June 1998, Solomon Islands Government Ministers and officials began to make requests to Airservices Australia for payments of air navigation fee revenue to third parties. The contracts did not provide for these payments to be made. Requests were received from the relevant Minister, the Permanent Secretary of the relevant Department and the Controller of Civil Aviation (the representative of the Solomon Islands Government nominated in the contract).

4.3 Figure 4.1 summarises the various types of payments made by Airservices Australia from air navigation fee revenue held on behalf of the Solomon Islands Government. Comparing Figure 4.1 with Figure 1.2 in Chapter 1 of this report shows that the administration of the payment of air navigation fee revenue to the Solomon Islands Government departed significantly from the approach specified in the contract.

Figure 4.1

Payments made by Airservices Australia from air navigation fees: July 1998 to April 2006



Source: ANAO analysis of Airservices Australia records, including those supporting the 2005 internal audit.

Previous reviews, inquiries and investigations

4.4 The first time concerns were raised about the use of air navigation fee revenue was in June 2001. This was in an article in the *'Solomon Star'* newspaper on 8 June 2001 alleging misuse of funds. Specifically, the article suggested that funds held by Airservices Australia on behalf of the Solomon Islands Government were not being properly accounted for and had been misused by three senior Solomon Islands Government officials.⁵⁰

4.5 On 12 June 2001, the Airservices Australia contract manager prepared a brief in relation to the *'Solomon Star'* article. This was used by the then Airservices Australia Company Secretary to provide a brief to the then Minister. The brief to the then Minister concluded that Airservices Australia had minimal legal exposure as all expenditure from funds held by Airservices Australia was approved by a senior member of the Solomon Islands Government.⁵¹ No further action was taken by Airservices Australia at this stage to conduct a thorough examination of the management of the contract.⁵²

4.6 Between July 2003 and November 2005, there were three internal audits by Airservices Australia of the management of air navigation fee revenue collected on behalf of the Solomon Islands Government. Over the period since concerns were first raised in 2001, there has been a considerable change in Airservices Australia's assessment of its performance in administering payments made from air navigation fees collected on behalf of the Solomon Islands Government. This is demonstrated by Table 4.1.

⁵⁰ A further article appeared in the *'Solomon Star'* on 20 June 2001. As a result of the second article, the Australian High Commission in Honiara provided a cablegram briefing to the Secretary of the Department of Foreign Affairs and Trade, the Secretary of DOTARS and the Airservices Australia Chief Executive. The cablegram was also provided for information to: the Prime Minister; the Deputy Prime Minister; the Minister for Foreign Affairs; the Minister for Trade; and six senior officials in various agencies.

⁵¹ On 19 July 2001, the Airservices Australia Board was advised of the allegations reported in the *'Solomon Star'* and that the Solomon Islands Government had confirmed that Airservices Australia's contractual arrangements remained suitable and were not at issue in the Solomon Islands Government's inquiry. As a result of the allegations, the three Solomon Islands Government officials were stood down.

⁵² In each year between 2000 and 2002, the relationship manager suggested to his manager that an internal audit be conducted of various aspects of the administration of the upper airspace management contracts, including payments being made from the air navigation fee revenue at the request of Solomon Islands Government officials. However, no internal audit was conducted until July 2003.

Table 4.1

Airservices Australia's changing assessment of its administration of payment of air navigation fees

Review	Purpose	Conclusion
<p>June 2001 review</p>	<p>The then Minister for Transport and Regional Services was informed of allegations of misuse of funds reported in Solomon Islands newspaper.</p>	<p>Airservices Australia was considered to have minimal legal exposure as all expenditure from funds held by Airservices Australia was approved by a senior member of the Solomon Islands Government.</p>
<p>July – September 2003 internal audit</p>	<p>Reassure the relationship manager that he had been administering the funds correctly and help provide advice on ways to improve the administration.</p>	<p>The contract appeared to be well managed. It was evident that as well as ensuring a high standard of ongoing accountability, the relationship manager had played a pivotal role in promoting Airservices and Australia's interests with this developing nation and regional neighbour. This often required a great deal of personal effort on behalf of Airservices over the past five years. It has been decided that the contract with the Solomon Islands Government should be managed strictly in accordance with the terms and conditions of the original agreement.</p>
<p>August – October 2003 Office of Security Risk Management review</p>	<p>Inquire into the conduct of the upper airspace management contract.</p>	<p>Payments had been made other than as provided for by the contracts, although written authority had been obtained for payments to third parties and receipts obtained where cash payments had been made. There may be a perception of corruption as payments made directly to parties rather than the designated Solomon Islands Government bank account would not be visible for normal audit purposes by Solomon Islands Government officials. However, no evidence was found that the relationship manager had any knowledge, or would have been able to determine, that any of the payments that he was requested to make were for any questionable or illegal purpose.</p>
<p>June – November 2005 internal audit</p>	<p>Verify that all payments had been authorised by the Solomon Islands Government and were supported by documentation and analyse payments to third parties.</p>	<p>Airservices Australia has a duty of care to responsibly manage funds received on behalf of another party. Throughout the period of the contract, in which we collected monies on behalf of the Solomon Islands Government, payments have been made to third parties that are potentially outside the strict terms of the agreement. There are improvements required in relation to administration processes surrounding the management of monies on behalf of a customer.</p>

Source: ANAO analysis of Airservices Australia documentation.

4.7 As discussed in Chapter 1, there is also an ongoing review of civil aviation being conducted by the Solomon Islands Auditor-General. This review includes examination of the financial transactions resulting from proceeds collected by Airservices Australia under the upper airspace management contracts. The work of this review gave rise to the 2005 Airservices Australia internal audit identified in Table 4.1.

4.8 In addition, in November 2004, the Australian Federal Police (AFP) commenced an investigation after a complaint was received alleging that an Australian contracted as an adviser to the Solomon Islands Government had made corrupt fraudulent payments within the aviation industry.⁵³ In terms of whether this investigation also considered the actions of employees of Airservices Australia, the AFP advised ANAO on 17 August 2006 as follows:

The AFP investigation, which commenced in November 2004, did investigate whether there were any breaches of Commonwealth legislation, in particular offences against the bribery of foreign official provisions of the *Criminal Code Act 1995* by Airservices Australia employees. The outcome of the investigation established there was no evidence to support a charge of criminal conduct contrary to Commonwealth law.

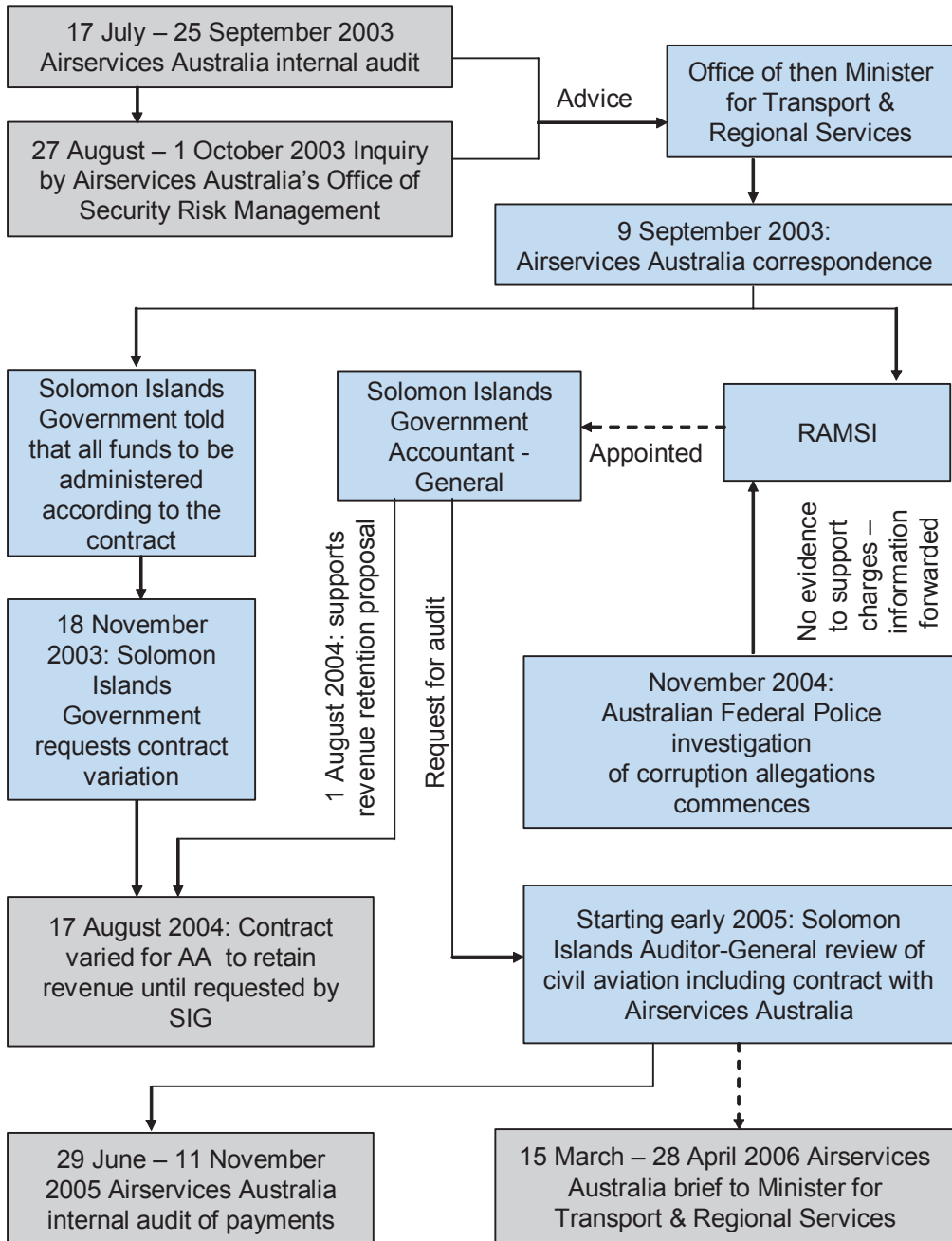
In May 2006, Airservices Australia requested a review of the previous investigation due to the discovery of additional material not previously made available to the AFP. The case was re-evaluated with consideration of the new material and was concluded in late June 2006. The re-evaluation did not alter the initial investigation findings.

4.9 Figure 4.2 provides an overview of the various reviews, their interrelationships and any resulting referral action.

⁵³ In investigating this allegation, in February 2005, the AFP obtained from Airservices Australia a copy of the October 2003 report of the Office of Security Risk Management review.

Figure 4.2

Reviews, inquiries and investigations



Source: ANAO analysis of Airservices Australia documentation.

Changed internal audit and governance arrangements

4.10 In June 2004, a review of Airservices Australia's internal audit functions was completed by a consulting firm. The findings included that planning was not coordinated, there was no direct and effective linkage between identified risks and audit activity, inadequate reporting of audit findings to the Board and its committees and audit activity was not providing assurance to management or the Board.

4.11 The key recommendation of the review of audit functions was that Airservices Australia's audit functions be structurally reformed by integrating the business risk auditing function with the safety and environment auditing function. The Airservices Australia Board was advised in May 2005 that the restructure and an associated recruitment campaign was designed to facilitate full implementation of the review recommendations by 31 December 2005.

4.12 In terms of the management of off-shore commercial activities such as the upper airspace contract with the Solomon Islands Government, at its May 2006 meeting, the Board Audit Committee was advised that:

The internal reviews conducted by Corporate Security in 2003 and Audit & Assurance in 2005 revealed gaps in Airservices approach to managing risk in off-shore activities. Some additional internal controls were subsequently implemented; however, it is acknowledged further improvements can be made.

4.13 Specifically, the Board was advised that a number of additional governance processes will be implemented progressively by 31 December 2006, including:

- implementation of a compliance system that was under development;
- adoption of draft "Anti-Bribery Guidelines – Operating overseas";
- training all employees travelling overseas or otherwise involved in the administration or management of off-shore activities. This training is to include the following topics: code of ethics; policy of gifts and benefits; anti-bribery guidelines for operating overseas; description of contract management principles (for example, separation of duties); and workshop of real life examples and hypothetical scenarios;
- expediting the implementation of more robust contract management controls and systems, as well as training for all Airservices Australia employees involved in the administration of contracts. The system is to

be aligned with Airservices Australia's authorisation and delegations procedures and include:

- contract approval and variation requirements, including the requirement for any contracts or variations to be endorsed by the Office of Legal Counsel and approved by the relevant General Manager and/or the Chief Executive Officer;
 - segregation of the contract service delivery and financial monitoring accountabilities; and
 - financial and operational reporting requirements, including the reconciliation of bank accounts and financial reporting to management;
- ensuring the complaints handling system being developed as part of the Compliance Improvement Program accommodates complaints generated by off-shore activities; and
 - reviewing the Performance Enhancement Program to ensure the Key Performance Indicators for Airservices Australia employees involved in the administration or management of off-shore activities support the governance processes.⁵⁴

Payments made from air navigation fee revenue

4.14 The majority (\$8.45 million or 80 per cent) of all payments made by Airservices Australia between June 1998 and April 2006 from air navigation fee revenue collected on behalf of the Solomon Islands Government related to either amounts retained by Airservices Australia as fees for its services, or payments to a Solomon Islands Government bank account.

4.15 The single largest category of payments (42 per cent or \$4.43 million) involved amounts retained by Airservices Australia in relation to the upper airspace management contract and other work it undertook on behalf of the Solomon Islands Government. These payments were provided for in the upper airspace management contracts.

⁵⁴ In the context of Airservices Australia's Performance Enhancement System, ANAO noted that the former relationship manager's performance agreements gave very significant weight to his performance in increasing other commercial revenue and developing new business opportunities in the Asia-Pacific region.

4.16 A further 38 per cent (\$4.01 million) of payments made by Airservices Australia between June 1998 and April 2006 were transfers to various Solomon Islands Government bank accounts. Each of the two upper airspace management contracts provided for air navigation fee revenue of the Solomon Islands Government, collected on its behalf by Airservices Australia, to be remitted to a specified Solomon Islands Government bank account.⁵⁵

4.17 However, \$825 000 was paid to a bank account not specified in the contracts.⁵⁶ Legal advice obtained by Airservices Australia in June 2006 is that payments to Solomon Islands Government bank accounts other than those specified in the relevant contract do not give rise to a breach of contract or other concern.

4.18 The remaining transactions (totalling \$2.12 million) involved:

- payments totalling \$2.10 million to third parties, and
- cash advances and payments totalling \$28 558 made using Airservices Australia corporate credit cards with subsequent reimbursement from air navigation fee revenue being held on behalf of the Solomon Islands Government.

4.19 These payments were not in accordance with the upper airspace management contracts.

Payments to third parties

4.20 Payments totalling \$2.10 million (nearly 20 per cent of total payments made from the air navigation fee revenue collected between June 1998 and April 2006) were made to third parties. Third party payments are not provided for in the contracts.

4.21 Third party payments commenced in February 1999, eight months after the commencement of the contract. The first payments made, between February and August 1999, were to third parties providing services relating to the development of global positioning satellite non-precision approach procedures at 12 aerodromes in the Solomon Islands. This was in accordance

⁵⁵ The specified account was changed in 2003 when the second contract was signed.

⁵⁶ This account was titled as an operations account for the Controller of Civil Aviation.

with a contract between Airservices Australia and the Solomon Islands Government, which explicitly provided for payments to third parties.⁵⁷

4.22 In September 1999, Airservices Australia began making other types of third party payments in response to requests from Solomon Islands Government Ministers and officials, as follows:

- a total of \$306 162 was paid between September 1999 and August 2003 for travel expenses, including for the purposes of accommodation, daily allowances and airfares;
- between February 2000 and September 2003, \$391 478 was paid in relation to student education expenses.⁵⁸ This included amounts for accommodation, daily spending money, tuition fees and airfares. From the limited information available within Airservices Australia for the transactions examined by ANAO, it appears that the Solomon Islands Government intended to employ these students in the Civil Aviation Division following the completion of their studies, or to retain them in employment if previously working for the department responsible for civil aviation; and
- a total of \$588 339 paid between May 2001 and September 2003 for the fees and expenses of an aviation adviser to the Solomon Islands Government.

4.23 As well as these categories, Airservices Australia made \$809 685 in payments to other third parties. This included: \$208 312 for insurance, \$136 802 for vehicles and vehicle repairs, \$107 104 to Solomon Islands airport contractors, \$42 730 for supplies and equipment, \$38 471 for airfield maintenance, \$31 658 in salaries and wages, \$30 842 to Solomon Telekom and \$1 942 for taxi fares.

4.24 Although not provided for in the written upper airspace management contracts with the Solomon Islands Government, the existence of the third party payments was reasonably well known and accepted within Airservices Australia. For example:

⁵⁷ In addition to Airservices Australia's fee of \$47 000, the contract included a provision that authorised Airservices Australia to make payments totalling \$63 000 to third parties for work they were to undertake as part of the project. This was principally a survey of runway ends, aerodrome reference points and navigation aid coordinates together with air transportation as part of the validation of the new procedures.

⁵⁸ Courses undertaken included law degrees, electronic degrees and mechanic engineer training, in a number of countries including Australia, New Zealand, Fiji and Vanuatu.

- as mentioned, the first subsidiary contract entered into between Airservices Australia and the Solomon Islands Government (for global positioning satellite non-precision approach procedures) that was funded by air navigation fee revenue explicitly provided for payments to third parties. This contract was prepared by Airservices Australia's Office of Legal Counsel;
- advice from the relationship manager to the Company Secretary, and from the Company Secretary to the then Minister, in responding to the June 2001 reports in the *'Solomon Star'*, explicitly stated that funds had been used to pay for training of Solomon Islands Government civil aviation staff at institutions throughout the Pacific and in Australia, repairs of equipment at Henderson Airport, training of aviation fire fighters, attendance at courses and meetings in the region and the purchase of vehicles;
- all payments were processed by either the Accounts Payable or Treasury areas of Airservices Australia, at the request of the relationship manager. An August 2003 internal audit found that each payment required the forwarding of supporting documentation before a payment could be processed;⁵⁹ and
- various reports of the relationship manager's visits to the Solomon Islands referred to third party payments. These reports were circulated at relatively senior levels within Airservices Australia.

Cash payments

4.25 Between February 2000 and June 2003, cash advances and payments totalling \$28 558 were charged to Airservices Australia corporate credit cards. These amounts were subsequently reimbursed to Airservices Australia from air navigation fee revenue held in an Airservices Australia bank account on behalf of the Solomon Islands Government. The terms of the upper airspace management contracts did not provide for such transactions.

4.26 In terms of these transactions, the June 2006 legal advice obtained by Airservices Australia on the various payments concluded as follows:

⁵⁹ However, in the course of this ANAO performance audit, the records held by the Accounts Payable and Treasury areas in a number of instances did not include the supporting documentation that the August 2003 internal audit said was provided to support payment processing. In July 2006, the former relationship manager advised the ANAO that supporting documentation had been provided for each payment.

It is unclear how those payments came to be made. The documentation before us does not indicate whether the payments were made following requests of Solomon Islands Government officials, which Solomon Islands Government officials made the requests, how those requests were made and whether the requests included a direction that the amounts be reimbursed from the Solomon Islands Trust Account [*sic*]. These are important matters in determining the validity or otherwise of those payments.

4.27 The corporate credit card transactions principally related to travel allowances and travel expenses. There were 17 transactions in total, one of which was a combined request for cash and payment of costs. Of the total amount:

- 13 payments totalling \$20 735 were made in cash.⁶⁰ Written authorisation existed in Airservices Australia's records for seven of the 13 cash payments. For each of the thirteen payments, the relationship manager obtained a receipt from the individual who received the funds;⁶¹ and
- the balance of \$7 823 involved five payments for air tickets and accommodation charges. Written authorisation was held by Airservices Australia for only one of these, which was the combined request for cash and payment to a third party.

4.28 Similar to the third party payments, the credit card transactions were known of within Airservices Australia. The credit card reimbursements were processed by the relevant finance sections within Airservices Australia. In addition, the October 2003 report of a review by Airservices Australia's Office of Security Risk Management noted that Airservices Australia's internal auditors, as part of regular reviews of credit card usage, had on a number of occasions advised the relationship manager that this practice was not in accordance with the corporate credit card conditions of use. However, as acknowledged in the report of the 2005 internal audit, the relationship manager asked for advice on alternative ways of meeting the requests being received from the Solomon Islands, but no suggestions were forthcoming.

⁶⁰ This was for travel allowances for individuals travelling to Australia, Malaysia, Singapore and Fiji; salary advances; imprest payments; and payment for car hire.

⁶¹ However, for one of these transactions, the receipt obtained was for \$1 000 whereas Airservices Australia's records state that \$2 000 was paid.

4.29 More broadly, prior to the report of the October 2003 review, the underlying principle as to whether cash payments should be made at the request of Solomon Islands Government Ministers and/or officials had not been explicitly addressed within Airservices Australia. In its review, the Office of Security Risk Management raised a number of concerns, including that the practice obscured the payments from Solomon Islands Government auditors. The report recommended that cash payments not be made to Solomon Islands Government officials for any reason, payments not be made to bank accounts or parties not named in the agreement and that the relationship manager's credit card be used in accordance with the terms and conditions of use.

ANAO assessment and use of powers

4.30 By Solomon Islands Government Ministers and officials making the various requests to Airservices Australia, and Airservices Australia making payments from the air navigation fee revenue in the manner requested, it could be argued that the parties had agreed to informally vary the contracts. This is despite the contract providing for variations to be made in writing.

4.31 However, even if contract variations allowing the payments had been made in writing, in the context of an Australian government entity collecting revenue on behalf of the government of another sovereign nation, making such payments was not prudent given the number and variety of payment transactions. The manner in which these transactions were processed as deductions from air navigation fee revenue may also have contributed to any irregularities in the use of this revenue by Solomon Islands Government Ministers and/or officials. In this context, the manner in which the payments were made was not transparent to Solomon Islands Government officials other than those requesting the payments.

4.32 As part of the audit, the powers available under Section 32 of the Auditor-General Act⁶² were exercised to obtain information from relevant former officers of Airservices Australia that were directly involved in negotiating and managing the contracts. Among other things, these officers affirmed to ANAO that they were not aware of:

⁶² Section 32 authorises the Auditor-General (or his delegate), in certain circumstances, to require a person: to provide information required by the Auditor-General; to attend and give evidence before the Auditor-General or an authorised official; and to provide documents to the Auditor-General.

- any evidence of improper or illegal financial transactions proposed or undertaken with the air navigation fee revenue;
- any evidence of involvement by Airservices Australia or any of its employees in assisting with inappropriate, improper or illegal use of upper airspace management funds; and
- Airservices Australia, or any of its employees past or present, receiving any financial or other benefit from the transactions undertaken on behalf of the Solomon Islands Government.

Authorisation of transactions by the Solomon Islands Government

4.33 The upper airspace management contracts provided the contract could be varied, in writing. However, the contracts were not formally varied. Instead, Airservices Australia relied upon authorisation from Solomon Islands Government Ministers and officials as sufficient basis to depart from the terms of the written contract when making payments from the air navigation fee revenue.

Ostensible versus actual authority

4.34 Legal advice obtained by Airservices Australia has provided inconsistent guidance on the extent to which authorisations from Solomon Islands Government Ministers and officials could be relied upon for making payments of air navigation fee revenue held on behalf of the Solomon Islands Government.

4.35 Shortly after allegations of misuse of air navigation fee revenue by Solomon Islands Government officials were published in the Solomon Islands press, legal advice was obtained from Airservices Australia's Office of Legal Counsel by the area responsible for administering the upper airspace management contract. The advice, dated 22 June 2001, was that:

- there was no express obligation for funds held by Airservices Australia on behalf of the Solomon Islands Government to be distributed for projects involving the advancement of civil aviation;
- as long as any oral direction for the allocation of funds was confirmed in writing, it was likely that the allocation of funds would comply with the contract; and

- the contract should not be varied to restrict the purposes for which these funds could be allocated as this would transfer the onus to Airservices Australia to ensure that the funds were not used for any project falling outside the stated purpose of the contract.

4.36 Consistent with the June 2001 internal advice, external legal advice obtained by Airservices Australia in June 2006 on issues associated with payments from air navigation fee revenue was that, providing requests to make payments to third parties were made with actual or ostensible authority of the Solomon Islands Government, it was open to Airservices Australia to informally agree to vary the payment arrangements and meet the Solomon Islands Government request.

4.37 External legal advice obtained by Airservices Australia in June 2006 drew attention to the need for Airservices Australia to ascertain whether Solomon Islands Government Ministers and officials had actual authority (not just ostensible authority). These issues were not raised by the internal legal advice provided in June 2001 to the area responsible for managing the upper airspace management contracts. As a result, no changes were made in 2001 to the procedures for processing requests from the Solomon Islands Government for payments to be made from the air navigation fee revenue.

Documentation evidencing authorisation by the Solomon Islands Government

4.38 On 9 September 2003, the Chief Executive of Airservices Australia informed the Regional Assistance Mission to the Solomon Islands (RAMSI)⁶³ of the outcome of the results of the two internal reviews conducted by Airservices Australia in 2003 of the administration of payments of air navigation fees.

4.39 RAMSI was advised that Airservices Australia had initiated steps to ensure that the contract was managed strictly in accordance with its conditions, and that it was reconciling all of the financial transactions made under the agreement. However, ANAO found that:

- Airservices Australia continued to hold in its bank account air navigation fees that the Solomon Islands Government did not request

⁶³ RAMSI was mobilised in July 2003 under the auspices of the Pacific Islands Forum following a request for assistance by the then Prime Minister of Solomon Islands. RAMSI's assistance has three broad strands: strengthening law and justice; budgetary and economic reform; and repair and reform of the essential machinery of government.

be remitted (the contract required such amounts to be paid to the Solomon Islands Government shortly after the end of each month). This was done at the request of the Solomon Islands Government, with the support of Airservices Australia, but the contract was not formally varied to support this approach until August 2004; and

- a reconciliation of all financial transactions was not undertaken until 2005, as part of the internal audit that was initiated as a result of the June 2005 visit to Airservices Australia by the Office of the Solomon Islands Auditor-General.

4.40 The 2005 internal audit was intended to examine all payments made by Airservices Australia from the commencement of the first contract in April 1998 up to 30 June 2005. The scope of this audit included:

- verifying that payments made by Airservices Australia were appropriately authorised by a Solomon Islands Government official (it did not examine Airservices Australia's own internal authorisation processes); and
- confirming supporting documentation was held from the Solomon Islands for all payments (it did not examine whether sufficient and appropriate supporting documentation was provided to, and/or obtained by, Airservices Australia's finance area when processing payment requests from the contract manager, as part of the segregation of duties that already existed).

4.41 The workpapers for this internal audit indicate, for each transaction examined, whether supporting documentation was located, whether the transaction had been authorised by the Solomon Islands Government and whether funds remitted to the Solomon Islands Government had been deposited into the account specified in the contract. However, the work papers do not sufficiently identify for each transaction the specific supporting documentation and authorisations being relied on.

4.42 The report of the internal audit stated that appropriate supporting documentation was eventually located for all but just over \$30 000 of third party payments made over the life of the contract.⁶⁴ In terms of authorisation, the internal audit concluded that the third party payments had been

⁶⁴ It did, however, conclude that the recordkeeping across the whole of Airservices Australia concerning the management of monies on behalf of a customer required improvement.

authorised by the Solomon Islands Government but they were potentially outside the strict terms of the contract.

Quarantining of revenue for civil aviation purposes

4.43 As outlined in Chapter 2, Airservices Australia has had a strategy to be the major provider of air space management and related services in the southern hemisphere. Nevertheless, it is important that Airservices Australia's commercial focus not overshadow the fact that it remains a Commonwealth statutory authority incorporated by an Act of the Australian Parliament for a public purpose.⁶⁵

4.44 Balancing these tensions is particularly important in situations where Airservices Australia is contracting with sovereign Governments. This was particularly the case in relation to the Solomon Islands, given the upper airspace management contracts have been in place during periods of internal conflict⁶⁶ and that corruption was always a potential risk.

4.45 In developing and administering the upper airspace management contracts, Airservices Australia was principally concerned with managing its commercial interests and related risks. In this respect, Airservices Australia:

- sought advice in December 1997 about Solomon Islands law generally and in relation to civil aviation. The focus of the questions was on air traffic operational issues concerning the capacity of the Solomon Islands Government to contract with Airservices Australia to manage the upper airspace, and any related requirements that needed to be met for this to occur;
- developed pricing strategies for the contract negotiations that were designed to cover costs and provide an adequate return. However, as the upper airspace management contract with the Solomon Islands Government was intended to assist Airservices Australia market its upper airspace management capabilities to other countries in the Pacific region, Airservices Australia did not set out to maximise its returns; and

⁶⁵ Section 7(1) of the CAC Act.

⁶⁶ This was reflected in the numerous changes to the relevant Solomon Islands Minister, Permanent Secretary and Controller of Civil Aviation over the period since the first contract was signed in April 1998.

- negotiated a contractual arrangement that managed the risk of it not receiving payment of its upper airspace management fees. Retaining Solomon Islands Government air navigation fees in an Airservices Australia bank account was also expected to provide a source of funds for other contracts Airservices Australia anticipated entering into with the Solomon Islands Government.

4.46 Airservices Australia also took an active role in developing operational arrangements to enable it to assume control of the upper airspace in the Honiara FIR. However, at no stage did Airservices Australia seek to satisfy itself that the revenue repatriation arrangements complied with Solomon Islands law and/or provided the necessary transparency to the Solomon Islands Government.

Constitutional requirements

4.47 To allow an external entity to collect its statutory revenue, the Solomon Islands Air Navigation (Air Traffic Control) Regulations of the Civil Aviation Act were amended by the Solomon Islands Government. As a result of the amendments, these Regulations specify that Airservices Australia is authorised to collect the air navigation fees for the upper airspace. In this respect, Airservices Australia is a collection agent of the Solomon Islands Government.

4.48 Governments raise statutory fees and charges by compulsion. Accordingly, it is common for the relevant constitution to require a separation between the collection of revenue and its subsequent appropriation for expenditure by the relevant Parliament.⁶⁷

4.49 The Solomon Islands Constitution came into operation on 7 July 1978.⁶⁸ It requires that 'all revenues or other moneys raised or received by or for the

⁶⁷ In this latter respect, the Solomon Islands Constitution provides that:

Withdrawal of money from the Consolidated Fund

101.-(1) No money shall be issued from the Consolidated Fund except upon the authority of a warrant under the hand of the Minister for Finance.

(2) No warrant shall be issued by the Minister for Finance for the purpose of meeting any expenditure unless –

(a) the expenditure has been authorised for the financial year during which the issue is to take place by an Appropriation Act;

(b) the expenditure has been authorised in accordance with the provisions of section 103 or 104 of this Constitution; or

(c) it is statutory expenditure.

⁶⁸ The UK established a protectorate over the Solomon Islands in the 1890s. Self-government was achieved in 1976 and independence two years later.

purposes of the Government be paid into and form one Consolidated Fund'.⁶⁹ The only exceptions provided to this, which require a relevant law to be passed by the Solomon Islands Parliament, relate to:

- revenues or moneys that may, by or under any law, be retained by the authority that received them for the purposes of defraying the expenses of that authority; or
- revenues or moneys that are payable by, or under, a law into a Special Fund established by the Solomon Islands Parliament.

4.50 The first exception has not applied in respect to the air navigation fee revenue collected by Airservices Australia on behalf of the Solomon Islands Government. This is because the funds were being retained by Airservices Australia for payment to third parties rather than being retained by the relevant Solomon Islands Government department for the purposes of defraying the expenses of that authority. In any event, Airservices Australia's records also do not provide any indication that the Solomon Islands Parliament has passed any laws authorising the defraying of expenses incurred by the relevant Solomon Islands department.

4.51 The second exception did not apply until 31 October 2005. On this date, the *Civil Aviation (Amendment) Act 2005* established the Aviation Special Fund. The Civil Aviation (Amendment) Act requires that all air navigation fees be paid into the Aviation Special Fund. The implications of the Aviation Special Fund for Airservices Australia's contractual relationship with the Solomon Islands Government are examined further below.

4.52 In this context, there would have been benefit in Airservices Australia identifying the requirements and/or conditions that needed to be satisfied in remitting air navigation fees collected on behalf of the Solomon Islands Government, to the Solomon Islands Government. In particular, obtaining an

⁶⁹ The relevant provision is:

Consolidated Fund and Special Funds

- 100.-(1) All revenues or other moneys raised or received by or for the purposes of the Government (not being revenues or other moneys that are payable by or under any law into some other fund established for any specific purpose or that may, by or under any law, be retained by the authority that received them for the purpose of defraying the expenses of that authority) shall be paid into and form one Consolidated Fund.
- (2) Parliament may make provision for the establishment of Special Funds, which shall not form part of the Consolidated Fund.
- (3) The receipts, earnings and accruals of Special Funds established under this section and the balance of such funds at the close of each financial year shall not be paid into the Consolidated Fund but shall be retained for the purposes of those funds.

understanding of the Constitutional requirements governing the collection and remittance of Solomon Islands Government revenue would have better informed Airservices Australia's management of its contracted role as collection agent.

4.53 Identifying the requirements and/or conditions that needed to be satisfied in remitting air navigation fees collected on behalf of the Solomon Islands Government would also have enabled Airservices Australia to query or decline the various payment requests received from Solomon Islands Government Ministers and officials. In this respect, in the course of his review of the administration of the upper airspace management contracts, the Solomon Islands Auditor-General has raised concerns that payments made to third parties by Airservices Australia from air navigation revenue collected and held on behalf of the Solomon Islands Government:

- effectively obscured the transparency of the payments from Solomon Islands Government officials and auditors; and
- contributed to irregular transactions taking place resulting in a loss of Solomon Islands Government funds.

Recommendation No.3

4.54 ANAO *recommends* that, prior to entering into future contracts that involve it acting as the collection agent of other governments, Airservices Australia take the necessary steps to identify the requirements and/or conditions that need to be satisfied when collecting and remitting statutory revenue.

4.55 Airservices Australia agreed to the recommendation and advised ANAO that its internal procedures have been amended accordingly.

The Aviation Special Fund

4.56 According to information provided to ANAO by the Office of the Solomon Islands Government Accountant-General in July 2006:

During the ethnic tension there were concerns from the international aviation industry that the Solomon Islands Government would not be able to meet international aviation safety requirements. To ensure there were certainty of funds for this purpose, in 2002 a separate bank account was opened. However this account was unconstitutional as there was no annual appropriation for expenditure or revenue and the bank account was not established pursuant to a special fund being created through legislation.

4.57 In this context, with effect from 31 October 2005, the *Civil Aviation (Amendment) Act 2005* (Solomon Islands Government) established the Aviation Special Fund. Under the Solomon Islands Constitution, Special Funds are separate from the Consolidated Fund and operate through bank accounts that are separate from those for the Consolidated Fund.

4.58 According to the Solomon Islands Government Accountant-General, key features of the Aviation Special Fund arrangements include that:

- the primary source of revenue will be air navigation fees, however the Special Fund may receive money from other sources;
- monies from the Special Fund can only be expended for purposes directly related to operating, developing and maintaining civil aviation infrastructure and facilities in the Solomon Islands in accordance with international safety standards, with the specific purposes specified in the legislation;
- there is a separate bank account maintained for the Special Fund, whose signatories (similar to the Consolidated Fund) are limited to public officers from the Department of Finance and Treasury;
- the Permanent Secretary of the Department responsible for aviation administers the Special Fund, but the Minister for Finance is to give directions to the Permanent Secretary for the control and management of the Special Fund; and
- financial statements are required to be prepared for the fund, and audited by the Solomon Islands Government Auditor-General.

4.59 In terms of the impact of the Special Fund, in January 2006, the Controller of Civil Aviation advised Airservices Australia that:

The Government has set up a Special Aviation Fund that separates the Upper Airspace money from the consolidated fund and uses it exclusively for Aviation. There are some very strict rules around what it can be spent on but it means we have surety of funding and will be able to rebuild the Aviation infrastructure over the next few years without having to be just one of several bidders for scarce funding from the consolidated fund.

Airservices Australia's fees

4.60 Up until the establishment of the Aviation Special Fund, all air navigation fee revenue was required to have been paid into the Consolidated Fund. From 31 October 2005, the Aviation Special Fund has required:

All air navigation fees paid under regulation 4 of the Air Navigation (Fees) Regulations in respect of aircraft that operate within that airspace above the territory of the Solomon Islands classified under that regulation as Class A shall be appropriated from the Consolidated Fund into the Aviation Special Fund.

4.61 Accordingly, there appears to be a tension between the requirements of the Aviation Special Fund and the terms of the contract, which allows Airservices Australia to deduct its fees before remitting the balance of air navigation fee revenue to the Solomon Islands Government. In these circumstances, Airservices Australia should seek to resolve this issue as soon as practicable.

Recommendation No.4

4.62 ANAO *recommends* that Airservices Australia consult with the Solomon Islands Government so as to ensure that the manner in which it is paid for managing the upper airspace in the Honiara Flight Information Region fully complies with the requirements of the Solomon Islands Constitution.

4.63 Airservices Australia agreed to the recommendation and advised ANAO that consultation has commenced. The Solomon Islands Government Accountant-General also commented on this recommendation, as follows:

The information reported in ANAO's report appears to be factual certainly in regards to the Constitution and the Civil Aviation Amendment Act. Also I agree with your interpretation of the "conflict" between remitting funds net of expenses (mainly the management fee) back to the Solomon Islands rather than gross as outlined in section 100(1) of the Constitution. I think the issue is readily resolved through an amendment to the contract and then the Solomon Islands Government paying through a recurring transfer to Airservices Australia each month the amount of the management fee. There will be some exchange risk depending on movements in rates but to some extent this risk does already exist but can be better managed depending on the timing of transferring funds back to Solomon Islands.



Ian McPhee
Auditor-General

Canberra ACT
18 October 2006

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