

Report 4 of 2021

Passenger transport
service contracts:
Heavy rail



Report of the Auditor-General

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Passenger transport service
contracts: Heavy rail

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*The Auditor-General's Department acknowledges and respects
Aboriginal people as the State's first people and nations, and
recognises Aboriginal people as traditional owners and occupants of
South Australian land and waters.*



**Auditor-General's
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House of Assembly
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Dear President and Speaker

**Report of the Auditor-General:
Report 4 of 2021 *Passenger transport service contracts: Heavy rail***

I present to each of you a copy of the report that is required by section 39(3f) of the *Passenger Transport Act 1994*.

Under section 39(3f) of the *Passenger Transport Act 1994* I am required to:

- examine the contract
- report on the probity of the process leading to a service contract being awarded for providing heavy rail passenger transport services in metropolitan Adelaide.

This report provides an update on the status of my review and the circumstances impacting it.

Acknowledgements

We appreciate the cooperation and assistance given by staff of the Department for Infrastructure and Transport during the review.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richardson'.

Andrew Richardson
Auditor-General

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1 Introduction

1.1 Background

Under the *Passenger Transport Act 1994* (PTA) the Minister for Infrastructure and Transport (the Minister) is responsible for providing passenger transport services in South Australia. The PTA allows the Minister to award service contracts for the operation of regular public transport services by tender or other such means as the Minister thinks fit. In 2019, the SA Government decided to invite tenders for heavy rail passenger transport services (heavy rail) from private contractors for the first time.

The Department for Infrastructure and Transport (DIT) plans, regulates and funds public transport services across South Australia in line with the PTA.

On 18 September 2020, following a procurement process run by DIT, the Rail Commissioner¹ executed a contract – the Outsourced Rail Operations Agreement (OROA) – with Keolis Downer for heavy rail passenger transport services.

The contract is for eight years (through to 4 February 2029) with a value estimated by DIT of \$1.374 billion inclusive of GST. There is an option for the Minister to extend for a further four years at a further value estimated by DIT of \$764 million inclusive of GST. Over the 12-year term the contract value is therefore estimated to be \$2.138 billion inclusive of GST.

Keolis Downer started providing the services from 31 January 2021. Under terms and conditions set out in the OROA, the SA Government has retained ownership of the rail system infrastructure and assets, and responsibility for setting and receiving fares and setting the requirements for service delivery. Keolis Downer is required to perform all work required to maintain the rail assets to the SA Government's specified standards, and to operate trains and deliver services to the schedule and performance standards determined by the SA Government.

I am required by section 39(3f) of the PTA to examine the contract and prepare a report on the probity of the processes leading up to awarding it. Section 34 of the *Public Finance and Audit Act 1987* (PFAA), which provides the Auditor-General's powers to obtain information, applies to the examination of a service contract and the preparation of a report. These powers establish an expectation of the standard the Auditor-General should bring to all audits.

The PTA requires the Auditor-General's report to be delivered to Parliament within four months of receiving a service contract and report from the Minister. I received a report from the Minister on 15 October 2020. Accordingly, the due date for my report is 15 February 2021.

¹ The Rail Commissioner is appointed under the *Rail Commissioner Act 2009*. The Commissioner's powers and functions are outlined in that Act and include entering into service contracts relating to the operation of passenger transport services under the PTA. The Minister and the Rail Commissioner entered into an agreement that sets out the conditions on which the Rail Commissioner can subcontract the operation of the Adelaide metropolitan passenger rail network.

2 Status of the audit at the time of this report

I am well progressed on my examination of the contract and my audit to prepare a report on the probity of the processes leading up to the awarding of the contract. I have not completed to my satisfaction all the audit procedures required by the Australian Auditing Standards to form a conclusion for this audit by 15 February 2021.

I have not made any conclusions or formed any findings or recommendations at this time because my audit is incomplete.

No conclusion or inference should be drawn from the fact the audit is not yet complete. It would be inappropriate for anyone to speculate on the potential outcome of my audit or assert any reason for the delay, beyond what I have stated in this report.

All parties are assisting me with my audit. DIT established processes with my staff to meet regularly, has provided documentation requested securely and in line with agreed deadlines, and has provided all other assistance we have requested.

2.1 Multiple factors impacting the audit

As noted, this is the first time the SA Government has awarded a contract to a private operator to provide heavy rail passenger transport services. Most audits of first-time arrangements require more time to audit than ongoing arrangements. The heavy rail procurement was conducted in a two-stage process (an expression of interest followed by an invitation to supply). The stages occurred over approximately 16 months, from the initial SA Government decision to transition to a contracted services model for Adelaide's rail services in May 2019 to the execution of the OROA in September 2020.

DIT advised us that it used a core project team of employees and contractors, supported by specialist external advisory services for engineering, legal and commercial matters, and that at various times, additional subject matter experts from DIT were used for specific aspects or tasks associated with the project.

DIT indicated that in response to our requests it had produced around 1450 documents for our review, covering the procurement from beginning to end.

During the procurement, a range of matters were raised in Parliament and in the media about the procurement, including the probity of the process.

The COVID-19 worldwide pandemic also started during the procurement. This resulted in various responses from all the parties involved. The invitation to supply was released on 24 February 2020. On 15 March 2020, the Chief Executive of the Department for Health and Wellbeing declared COVID-19 to be a public health emergency. On 22 March 2020, the Premier announced the closure of South Australian borders from 24 March 2020, with anyone entering from overseas or other states or territories required to self-isolate for 14 days. The invitation to supply closed on 1 June 2020.²

² With the exception of providing certain supporting financial information, which closed on 9 June 2020.

All of these circumstances have impacted my capacity to complete the audit within the four-month statutory time frame.

In performing my audit of the heavy rail procurement, I need to consider any matter that may be material to my statutory obligation to report on the probity of the processes leading up to the awarding of the contract.

2.2 Next steps – reporting under the PFAA

I took legal advice and formed the view based on this advice that the time limit specified in section 39(3f) of the PTA does not allow for the Auditor-General to conduct an audit under the PTA, or deliver a report after the expiry of the four-month period. I was also advised that an audit could be undertaken and a report prepared for Parliament under the PFAA. Consequently, I have prepared this report as required by the PTA and I will complete an audit and report on that under the PFAA.

I am continuing the work I have been doing to report to Parliament on my examination of the contract and the probity of the processes leading up to the awarding of the contract for heavy rail passenger transport services.

I will conduct an audit under section 31(2) of the PFAA. When I have satisfactorily completed all the procedures necessary for my audit I will report to Parliament, under section 37 of the PFAA, the results of my audit and the conclusion I form on the matters required by the PTA. I am professionally bound by Australian Auditing Standards to ensure I meet specific requirements before issuing an assurance opinion. I must obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. What is sufficient is a matter of judgement and requires an assessment of risk by the auditor.

2.3 Report target date of May 2021

I now expect to report to Parliament in May 2021 on my examination of the contract for heavy rail passenger transport services and the probity of the processes leading up to awarding it. I intend to report on both the contract examination and the procurement process as I regard these two matters as inseparable, the contract deriving from the procurement process.

Section 2.4 outlines the approach we are taking to complete this audit.

2.4 Audit scope

The PTA requires the Minister, on awarding a service contract to operate regular passenger services with a value of \$4 million or more, to provide the Auditor-General with:

- a copy of the service contract
- a report on the processes leading to the award of the contract.

As noted, I received a report from the Minister on 15 October 2020.

The PTA requires the Auditor-General to:

- examine the service contract
- prepare a report to Parliament on the probity of the processes that led to the contract being awarded within four months of receiving the contract and the report from the Minister.

2.4.1 Examination of the contract

In examining the service contract, we are assessing whether the Minister addressed specific requirements in the PTA in conducting processes leading up to and following the awarding of it. This includes whether the Minister and DIT had effective processes to properly consider the following four principles outlined in the PTA:

- avoiding a monopoly
- developing sustainable competition
- integrating passenger transport services
- efficiency and promoting innovation.

We are assessing whether matters required to be included in the contract by the PTA were included. We are also considering whether the contract protects the State's interests.

2.4.2 The probity of the process

To assess the probity of the procurement process we are considering whether DIT effectively implemented a procurement process that addressed:

- concepts and requirements in the State Procurement Board³ policy framework
- the probity principles outlined in section 2.4.3.

We are also considering whether:

- procurement procedures, processes and probity controls outlined in the procurement acquisition plans, evaluation plans and probity plan were effectively implemented
- expression of interest and invitation to supply (tender) requirements were followed.

2.4.3 Key probity principles

For the probity of the process leading up to the awarding of the service contract we identified key probity principles to use in conducting our review. We considered State Procurement Board policies and guidelines. We also considered our previous reviews of the procurement of bus and light rail passenger transport services and DIT's probity plan.

³ The State Procurement Board was established under *the State Procurement Act 2004* to oversee procurement operations for public authorities. It developed and issued policies, principles and guidelines directed to providing for ethical and fair treatment of participants and ensuring probity, accountability and transparency in procurement operations.

We identified the following key probity principles for our review of the procurement:

- compliance with the law
- transparent and consistent decision making
- security and confidentiality of information
- providing fairness, impartiality, integrity and equality to all parties
- managing conflicts of interest
- conducting an appropriately competitive process
- maintaining records, including an audit trail that enables independent review of processes.

3 Some observations about the PTA audit obligations for Parliament

3.1 Reporting within four months

I acknowledge that in all previous circumstances, including my recent report on bus and light rail,⁴ a report was prepared within the time set in the PTA.

I also acknowledge the subject matter of section 39 of the PTA, being a contract for an essential service entered into with a private entity, and the importance of any probity related concerns warrants audit work being completed expeditiously. Consequently, I understand that Parliament intended with the PTA for audit work to be completed within the prescribed four-month period.

I have explained that on this occasion, I was unable to complete the audit within four months. I assure Parliament that my staff and I are working to complete the audit expeditiously.

In my view, the circumstances for this audit that I have explained in section 2 warrant the additional time it will take. In these circumstances they warrant the conduct of additional audit procedures.

I note that audits of this nature are significantly different to the annual audits I conduct for financial statements and controls opinion work. Most large public authority audits are completed over 12 months to ensure the full year of activity is audited as required. In addition, most large-scale, single topic audits I have performed and reported to Parliament in recent years take well in excess of four months to satisfactorily complete. That is, to address all issues and related statutory and professional audit requirements prescribed in Australian Auditing Standards for planning, executing and reporting with appropriate procedural fairness.

Whether the four months provided in the PTA remains an appropriate time allowance for future procurements is a matter I believe Parliament should consider.

⁴ Auditor-General's Report 10 of 2020 *Passenger transport service contracts: Bus and light rail*.

3.2 The \$4 million threshold

I also note that the PTA establishes a threshold of \$4 million total contract value for passenger service contracts awarded that the Auditor-General must review. I respectfully suggest that this warrants consideration by Parliament.

My reasoning is that across government each year, the State enters into many more contractual arrangements of varying complexity and in excess of \$4 million in value than can reasonably be subject to individual audit attention.

The PFAA provides for the Auditor-General to exercise discretion in the priority given to a particular matter in carrying out functions under the PFAA.⁵

I have previously reported to Parliament that, in my term as Auditor-General, I have endeavoured to ensure we apply our audit resources to the most material matters relevant to any audit period. I have performed detailed audits on many individual projects and large contracts.⁶ We also annually conduct control opinion audits that look at systems of control. This takes account of the importance of good control systems for all financial transactions. It also inherently acknowledges that audits are unlikely to be able to look at all individual transactions.

Audits performed subject to the PTA are conducted in a manner that requires assigning significant, dedicated audit resources.

The audit of the recent bus and light rail contracts (\$3.008 billion over 10 years) and this audit of the heavy rail contract (\$2.138 billion over 12 years) are consistent with the Auditor-General providing independent assurance to Parliament about significant and material public financial transactions in a timely way.

A statutory requirement to audit much lower value public transport contracts as they occur is likely to result in the Auditor-General being unable to assign resources to other concurrent, more material transactions by value or nature.

⁵ s24—Appointment of Auditor-General

...

- (6) *The Auditor-General is not subject to the direction of any person as to—*
- (a) *the manner in which functions are carried out or powers are exercised by the Auditor-General under this Act; or*
 - (b) *the priority that he or she gives to a particular matter in carrying out functions under this Act.*

⁶ Examples include Auditor-General's Report 11 of 2019 *Darlington Upgrade Project*, Report 12 of 2018 *Land services commercialisation project*, Report 2 of 2018 *New Royal Adelaide Hospital* and Report 13 of 2017 *Adelaide Riverbank (Festival Plaza) Development*.

