

The Auditor-General

Audit Report No.11 1999–2000

Performance Audit

Financial Aspects of the Conversion to Digital Broadcasting

**Australian Broadcasting
Corporation
Special Broadcasting Service
Corporation**

Australian National Audit Office

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ISSN 1036-7632
ISBN 0 644 39138 3

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Canberra ACT
21 September 1999

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit of the Australian Broadcasting Corporation and the Special Broadcasting Service Corporation in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Financial Aspects of the Conversion to Digital Broadcasting*.

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



P. J. Barrett
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

AACF	Arthur Andersen Corporate Finance (Consultants)
ABC	Australian Broadcasting Corporation
BBC	British Broadcasting Corporation
CBC	Canadian Broadcasting Corporation
ANAO	Australian National Audit Office
DRB	Digital Radio Broadcasting
DTTB	Digital Terrestrial Television Broadcasting
FTA	Free-To-Air
HDTV	High Definition Television
IT	Information Technology
MHz	Megahertz
NPV	Net Present Value
NTN	National Transmission Network
SBS	Special Broadcasting Service Corporation
TV	Television

Summary and Key Findings

Summary

Introduction

1. The introduction of digital broadcasting marks a significant shift in communications technology away from the analogue¹ system which has been used in Australia from the first days of radio 75 years ago and since television broadcasting began in 1956. The new technology will offer the possibility of a wider range of services, including high definition television, multi-channelling (for both radio and television) and data transmission. For broadcasters and their audiences the introduction of this new technology transforms the broadcasting environment, bringing new opportunities and also new costs.

2. In March 1998, the government announced a digital technology policy for Australia. Under the policy Digital Terrestrial Television Broadcasting (DTTB) would be required in metropolitan areas by 1 January 2001 and in regional areas over the following three years, so that all of Australia would have access by 1 January 2004. Broadcasters were also required to maintain their existing services in analogue format for an eight-year simulcast period.² In mid-1998 the enabling legislation was passed in the form of the *Television Broadcasting Services (Digital Conversion) Act 1998* and the *Datacasting Charge (Imposition) Act 1998*.

3. In November 1997, the cost of the first phase of digital conversion for the Australian Broadcasting Corporation (ABC) was estimated at \$107.5 million over five years, with the ABC contributing \$66 million (comprising \$36 million from property rationalisations and \$30 million from its annual capital allocations). The ABC asked the government to meet the balance of \$41.5 million.

4. The cost of the first phase of digital conversion for the Special Broadcasting Service Corporation (SBS) was initially estimated at \$21.55 million over five years, with the SBS contributing \$4.65 million (comprising \$0.75 million from the sale of its transmitter site at Craigieburn in Victoria and \$3.9 million from its annual capital allocations). The SBS asked the government to meet the balance of \$16.9 million.

¹ Under analogue broadcasting, the picture, sound and other information is transmitted as a continuous wave form. Analogue signals can be easily distorted and require a clear and unobstructed delivery path from broadcaster to viewer.

² The government has also made provision for the eight-year simulcast period to be adjusted through regulations depending on needs of particular areas and takeup factors.

5. In April 1998, the government agreed to provide \$20 million over five years (indexed to \$20.8 million) to assist the ABC with off-Budget borrowings and \$16.9 million over five years to the SBS (indexed to \$17.7 million), towards the costs that both broadcasters would incur in implementing Phase 1 of their respective strategies. The government also agreed to give further consideration to the need for additional funding after two years when greater certainty would exist about the proceeds from property rationalisations and the costs of subsequent phases and in the light of a report to be requested from the Auditor-General.

6. In July 1998, the Chairman of the ABC wrote to the Minister for Communications requesting an early decision about the balance of funds to be provided by the government. The ABC stated that it would need to take on significant borrowings if it were to proceed with its digital conversion strategy and it was reluctant to do so without greater certainty about how this debt would be repaid. In August 1998, the Chairman advised the Minister that estimated borrowings for Phase 1 would result in an outstanding debt at the end of five years of some \$31 million. He requested that all debt management and financing costs associated with any borrowings required to be undertaken by the ABC for Phase 1 be met by the government.

7. In October 1998, in a letter to the Minister for Communications, the Prime Minister agreed that the Commonwealth would cover the outstanding debt in relation to Phase 1 of the ABC's digital conversion plans at the end of the five-year conversion period (that is, 2002-03). It was also agreed that any windfall gains accruing to the ABC from property rationalisation or other relevant sources must be used to repay Phase 1 debt. The government also decided that it would bring forward its request for the Auditor-General to assess financial aspects of the ABC and SBS digital conversion strategies.

8. At 30 June 1999, the estimated cost of Phase 1 for the ABC had risen to \$119 million (comprising \$110 million capital costs and \$9 million for interest on borrowings) and Phase 1 costs for the SBS had risen to \$22.55 million.

9. The ABC and SBS submitted their Phase 2 estimates to the government in mid-1999. The ABC sought \$74 million for delivery of DTTB and identified additional operational costs of \$78 million per annum once the rollout is completed. The SBS identified capital costs of \$38.7 million for the period 1999 to 2008 and annual operating costs for the final system of \$80.7 million.

Background to the audit

10. In November 1998, the Minister for Communications wrote to the Auditor-General requesting an assessment of the actual costs of Phase 1 digital conversion for the ABC and SBS, the sources of funds applied and the efficiency with which the funds had been used before the government considered further funding. Later that month the Auditor-General agreed to undertake a general performance audit under Section 18 of the *Auditor-General Act 1997*.

Audit objectives and approach

11. The purpose of this limited scope performance audit was to assess a range of financial issues associated with the ABC and SBS conversion to digital broadcasting. The audit objectives were agreed in correspondence between the Auditor-General and the Minister in February 1999. The Minister also advised that the digital strategies, provided to the government by the ABC and SBS in late 1997, should form the baseline for the audit. Specifically the audit examined:

- the ABC and SBS Phase 1 estimates and the quality assurance processes adopted to give confidence that they reflect the minimum reasonable costs of the conversion to digital broadcasting;
- expenditures to date by the ABC and SBS in Phase 1 to determine the extent to which they conform with the terms of the government's funding decision;
- the estimated and actual quantum and timing of funds generated from the broadcasters' property relocation strategies and other sources to ensure all net property proceeds have been directed to digital conversion and identify any significant variations from estimates for the funds obtained from property and other sources; and
- the payment and financing arrangements in place for the purchase or lease of digital conversion equipment to ascertain whether they are designed to minimise the call on budget funds.

12. The audit concentrated on the costs and funding of the conversion to digital broadcasting (as at 30 June 1999) and not on issues of engineering design or property relocation strategies, which were outside the audit scope. In scoping the audit, the ANAO took into consideration the findings of the reports by Arthur Andersen Corporate Finance (AACF)³ to the government and a number of external expert reviews

³ AACF prepared two reports on the broadcasters' digitisation strategies, a *Review of the ABC and SBS Digitisation Strategies* (December 1997) and an *Evaluation of the ABC's Digitisation Strategy: Follow-up Consultancy* (March 1998.) The consultancy involved comparisons with UK broadcasters and AACF also drew on the broadcasting expertise of a UK-based affiliate who travelled to Australia for the consultancy.

commissioned by the national broadcasters of their asset and loan portfolios.

13. The broadcasters' Phase 2 proposals were not reviewed by the ANAO as they were outside the scope of the audit.

Overall conclusions

14. The ANAO noted the involvement and technical expertise of AACF in assessing the ABC and SBS digital conversion strategies and found that the broadcasters had developed appropriate methods for the formulation of their estimates. In light of AACF's involvement, advice given to the government, and its acceptance of the scope of those strategies and associated costings, the ANAO concluded that the overall processes involved in compiling the Phase 1 estimates gave confidence that the ABC and SBS digital strategies reflected the minimum reasonable costs for this phase of their conversion to digital broadcasting.

15. ABC expenditure on digital conversion in 1998–99 was significantly lower than the \$30.2 million indicated in its November 1997 submission to the government. The SBS spent more in 1998–99 on its digital conversion than originally estimated. Sample testing by the ANAO of digital purchases confirmed that the 1998–99 expenditures undertaken by the ABC of \$5.2 million and SBS of \$4.4 million, were consistent with the government's funding decision.

16. The ANAO was not able to reach any conclusions about the quantum of proceeds from property rationalisations, as no relevant properties had been sold at the time of the audit. This followed delays in approving the strategy for the disposal of surplus properties.⁴ There were indications that the proceeds may ultimately be higher than forecast and the funds will also be realised earlier than originally estimated in 1997. However, the earlier realisation of funds does not provide a significant financial benefit. The ABC has instituted mechanisms that should allow the ready tracking of proceeds from asset realisations to expenditure on digital conversion. The SBS leased out its Craigieburn transmitter site, which it had initially planned to sell. This affects, to a minor extent, the quantum and timing of the funds to be applied by the SBS to digital conversion.

17. The ANAO has highlighted a number of other sources of revenue potentially available to the national broadcasters. For the ABC, these include the opportunities being explored by the ABC Board to derive

⁴ In February 1999 the ABC Board approved strategies for the sale or rationalisation of properties at Gore Hill, Brisbane, Canberra and Perth.

earnings from the activities of ABC Online (the ABC's Internet service), in addition to a range of existing sources of revenue which have traditionally been allocated to programming, such as dividends from ABC Enterprises, co-productions offsets, other business income and interest received. The SBS also derives additional revenues from sources such as its advertising activities and rental of surplus warehouse space in its Artarmon building which, in the main, have also traditionally been allocated to programming. The ANAO noted that there had been significant growth in the income received by the ABC and SBS from some of these sources in recent years. The allocation of these funds is the prerogative of the relevant Boards.

18. The broadcasters have not been in a position to identify or quantify the new opportunities for generating funds arising from the digital environment (for example, sub-leasing residual DTTB capacity to transmit data-casting services). However, these may become apparent when government policy reviews (covering issues such as multi-channelling by the national broadcasters) are finalised and as the conversion proceeds.

19. Both the ABC and SBS have drawn down funds from government contributions in advance of need, although the cost to the Commonwealth is not significant.

20. The ANAO notes that, in the period since the assumptions underpinning the government's decisions on Phase 1 funding were made, there have been changes in the financial position and environments within which the ABC and SBS have operated, viz:

- the levels of assets, equity and annual surpluses recorded by the ABC and SBS have increased; and
- net borrowings for both broadcasters have declined significantly, by \$50 million for the ABC and by \$12 million for the SBS, against a background of falling interest rates and generally increased loan affordability.

21. The ANAO recognises that the financial management of the national broadcasters is a matter for their respective boards and management. Within the agreed objectives of the audit, it is not the role of the ANAO to comment on the boards' strategies and expenditure priorities.

Key Findings

Preparation of estimates

22. Both broadcasters developed strategies and cost estimates for Phase 1 of their digital conversion programs that were submitted to the government and form the basis of their current implementation. AACF had previously provided overall endorsement of the SBS proposed level of spending and choice of technology, and also the cost and specification of equipment proposed by the ABC.

23. The ANAO found that the ABC and SBS had developed appropriate methods for the formulation of their estimates. The SBS submitted a master-list of its equipment requirements to the government as part of the digital strategy. The ABC adopted an outcomes-based approach and its submission to the government did not contain a consolidated master-list of the ABC's equipment requirements against which subsequent revisions and purchases could be easily checked. Its estimates also included a regional enhancement component, which was accepted by the government.⁵

24. The ABC advised that it was not in a position at the time to prepare a detailed list of its digital requirements. In October 1998, it developed a list of digital television equipment requirements that has been periodically updated since then.⁶

25. The ABC revised its Phase 1 estimates from \$107.5 million to \$110 million immediately prior to the government's funding announcement in April 1998. After the funding announcement it revised its estimates to \$118 million, then to \$119 million, including the consequential costs of borrowings (\$8 million and later \$9 million). The direct funding sought from the government⁷ has risen from \$41.5 million to an estimated \$53 million (including interest costs of borrowings). The cost of the Phase 1 conversion has risen on initial estimates and the ABC revised the timing of its expenditure, details of which were forwarded to the government at the beginning of July 1999. The ABC advised that it is committed to achieving Phase 1 outcomes within its budget of \$110 million (excluding interest costs).

⁵ In correspondence to the Auditor-General dated 25 February 1999 the Minister advised that the Government accepted inclusion of the enhancement components in the ABC's Phase 1 strategy.

⁶ The listing totalled \$132 million at February 1999 and had risen to \$160 million by August 1999. It includes some Phase 2 requirements.

⁷ Covering the shortfall between what the ABC is contributing and the total costs of Phase 1.

26. The SBS estimated the cost of Phase 1 of digital conversion at some \$21.5 million over five years. It adopted a robust approach to its digital conversion planning, which generally involved the one-for-one replacement of analogue with digital equipment. There have been some subsequent adjustments to the pattern of expenditure and some minor alterations to the estimates, although these do not have a significant impact on government funding requirements.

27. For the most part the mechanisms developed by the ABC and SBS for tracking digital expenditure function well. However, in the case of the ABC, because there was no consolidated master-list of equipment included in the digital strategy to support the original estimates, it is not possible to readily reconcile current estimates of equipment requirements to the original costings submitted to the government.

28. The ABC advised that its strategy was based on outcomes and that it was endorsed by AACF and accepted by the government. The ABC also advised that it has delayed its Phase 1 investment pending resolution of the final government policy on DTTB. It stated that a considerable amount of planning work is underway to allow integration of digital conversion with property rationalisation across Australia to ensure that the ABC will meet the 1 January 2001 digital start date. Its strategy has been to seek the most cost-effective conversion through bulk purchase and close coordination of digital conversion of internal plant under Phase 1 with the implementation of digital delivery to the public under Phase 2.

29. The ABC developed a new Phase 2 submission for government consideration that brings forward the HDTV production systems that were previously outside the five-year planning period requested by the government. The SBS submitted its costings for Phase 2 to the government at the end of June 1999.

Expenditure to date

30. ABC expenditure on digital conversion during 1998–99 amounted to less than five per cent of the total planned for Phase 1 and was considerably less than the \$30.2 million indicated in the November 1997 submission to the government. The SBS spent more in 1998–99 on its digital conversion than the \$3.7 million originally estimated. Sample testing by the ANAO of digital purchases confirmed that the 1998–99 expenditure undertaken by the ABC of \$5.2 million and SBS of \$4.4 million, up to 30 June 1999, was consistent with the digital conversion strategies forwarded to, and approved by, the government. However, the ANAO noted that some \$0.88 million included in the ABC's expenditure related

to the leasing of personal computers and associated software. It was also noted that in relation to this type of expenditure AACF commented in March 1998 that it:

. . . involves the upgrade of the internal communication network via a multimedia capable personal computer with text editing equipment and audio/video editing software. This capability complements the digitisation process but does not form part of the conversion process.⁸

31. Overall, the systems developed by the ABC and SBS to record and track digital conversion expenditure functioned appropriately. However, the ANAO suggested that the ABC's input controls over descriptions of digital purchases that are entered into its new SAP financial management system could be improved.

Property sales and other revenue sources

32. The ABC's submission to the government envisaged a contribution of \$36 million towards the cost of digital conversion by the ABC from the rationalisation of some of its property holdings. Funds from ABC property sales are to be realised in two tranches:

- The first tranche of around \$14 million (from the sale of properties in Kununurra, Melbourne, Frenchs Forest in Sydney and Hobart) did not form part of the five-year digital strategy. However, the Board had earmarked the expected proceeds for digital equipment purchases that the ABC said could not be specified at the time. The ABC stated that \$3.77 million was spent on digital projects from the proceeds of the first tranche of property sales in 1997–98.
- There was no detailed list of equipment that underpinned either the pre-Phase 1 or Phase 1 digital projects. The ANAO acknowledges that, given the scale of the ABC's digital strategy, it would have been difficult to compile a detailed list of specific equipment required. Although the ABC advised that systems are in place or will soon be in place to track pre-Phase 1 expenditure, without a reconcilable list of items covered by either pre-Phase 1 or Phase 1 projects there remains scope for varying interpretations of what was included in the ABC's approved digital strategy. Such details would also assist both the ABC and the ANAO in tracking Phase 1 digital expenditure.
- Delays have occurred in finalising the strategies for the second tranche of ABC properties to be sold. A potential windfall of some \$5 million and possibly up to \$8 million over the projected figure of \$36 million

⁸ AACF March 1998 Final Report, p.64.

is likely from these properties, excluding any windfall that may be received from the sale of surplus land at the Gore Hill site.

- On current projections, revenue from the sale of the second group of properties is expected to be realised earlier than originally estimated. However, the increase in the Net Present Value⁹ of the expected property proceeds as a result of this change in timing is estimated to be only \$0.23 million.

33. Although the SBS had intended to sell its Craigieburn property it became evident that the sale would not proceed and the property has been leased out. This moderately affects the quantum and timing of the funds available to be applied by the SBS to the costs of digital conversion. However, it is not material. The SBS advised that it cannot sell the property until the transmission facility that operates from the site is relocated.

34. The ANAO found that the ABC had instituted mechanisms that should allow the tracking of proceeds from its property sales to expenditure on digital conversion. These included the designation of separate digital accounts within the ABC's new financial management system and identifier codes for related property sale costs and proceeds.

35. There are several potential sources of other revenue available to the ABC. Opportunities were being explored to derive an ongoing revenue stream from ABC Online activities. To this end a new unit has been established to coordinate the online service's business development. The relevant ABC Board paper made it clear that any revenue generated by ABC Online is to be returned to program making. Although not endorsed by the ABC Board, it has been suggested that the sale of 49 per cent of ABC Online may generate around \$250 million that could be applied to ABC programming or other purposes. It should be noted that this estimate has not been tested.

36. For the SBS, other potential revenue sources include income from the rental of surplus warehouse space in its Artarmon building that was estimated by the SBS in 1997 as being able to contribute about \$2 million over the first five years of the digital conversion process. The ANAO found that the income from this stream was not included in the strategy given to the government. The SBS advised the ANAO, however, that the identified rental income was already committed.

⁹ Net Present Value (NPV) is a discounted cash flow method of capital investment appraisal. For example, \$110 due in one year's time, discounted at 10 per cent, will have a NPV of \$100. In ranking options, the one with the highest NPV will be ranked first as it will add most to the wealth of the entity.

37. The ANAO noted that other income received by the SBS had increased by some \$10 million from around \$18.6 million in 1996–97 to almost \$29 million in 1998–99. A major contributor to this was the significant increase in gross annual advertising revenue, which rose from \$11.87 million in 1996–97 to \$21.24 million in 1997–98 and was \$19.47 million in 1998–99. The SBS advised that its increased advertising revenue was largely due to the World Cup and the revenue generated by the World Cup was more than offset by the additional expenditure required to cover this event. The SBS said that there has been very little or no increase in net resources available to it from advertising revenue.

38. There may also be new revenue opportunities for the national broadcasters from the sale or marketing of digital bandwidth that emerge as their strategies for digital broadcasting are progressively implemented but these, with minor exceptions, have not yet been identified or quantified by either the ABC or SBS. The ABC stated that broadcasters are not in a position to identify these. However, the ANAO considers they may become apparent when government policy reviews are finalised and as the conversion proceeds.

39. The SBS acknowledged that funds may be available from new services such as data casting. However, it considered this is an emerging and unstable market which is unlikely to generate significant income streams during the conversion to digital and could not be relied upon to fund a conversion strategy.

40. The ANAO also noted that, in its November 1997 submission to the government, the ABC identified that some \$5 million to \$10 million in operational savings would be available over the five years of Phase 1 as a result of the introduction of digital technology, but the nature of these savings has not been specified. The SBS had not identified any efficiencies potentially available from the use of digital technology.

41. The ANAO recognises, however, that some of the above revenue streams have been earmarked for program purposes and that it is the responsibility of the ABC and SBS Boards to determine priorities on strategic issues of this kind.

Payment and financing arrangements

42. The ABC and SBS had both drawn down funds for digital conversion from Parliamentary appropriations in advance of need. The ANAO found that the:

- ABC's expenditure of \$5.2 million on digital conversion during 1998–99 could have been funded from its own annual capital contribution of \$6 million, for which it had the cash reserves. The \$4 million government

funding contribution was invested and the interest is to be applied to the digital conversion debt. The ANAO calculated that the early drawdown of funds during 1998–99 did not provide the ABC with a significant financial advantage. However, as a good practice principle, funding should be drawn down only on the basis of needs.

- SBS's 1998–99 digital expenditure of \$4.4 million could also have been funded from the SBS capital contribution (\$0.5 million) and the significant cash reserves held by the SBS, which were around \$25 million in March 1999 and almost \$12 million at 30 June 1999. The SBS drawdowns of the \$3.2 million government contribution were considerably ahead of the actual digital expenditure.

43. The ANAO considers, however, that it is a matter for the government to decide whether it wishes to supplement appropriations by allowing the ABC and SBS to receive and invest funds before they are required.

44. In examining whether the ABC and SBS had considered the option of leasing digital equipment, the ANAO found that:

- because it was in the early stages of tendering and not in a position to approach the market with a firm list of equipment requirements and prices, the ABC had not given significant consideration to the costs and benefits of leasing versus outright purchase of its digital equipment requirements. The ABC stated that it remained open to case-by-case consideration of leasing where this offers significant benefits; and
- the SBS had considered leasing of digital equipment when it was developing its digital conversion capital funding plan but found this was a less favourable option.

45. One option for minimising the call on Budget funds is for the national broadcasters to borrow some or all of the funds needed for digital conversion. It should be recognised, of course, that there must be a capacity to repay any borrowings drawn down. Changes have occurred in the financial situation of the ABC since the assumptions underpinning the government decisions on Phase 1 funding were made. These include significant increases in the levels of assets (up by \$170 million), equity (up by \$207 million) and accumulated surpluses (up by \$63 million);¹⁰ and a \$50 million decline in net borrowings,¹¹ against a

¹⁰ Between 30 June 1996 and 30 June 1998. Figures for the ABC's assets, equity and surplus as at 30 June 1999 were not available at the time of preparation of this report.

¹¹ Based on unaudited figures provided by the ABC for its borrowings and liquid assets at 30 June 1999. At the time of its digital funding decision the government was advised that the ABC would have a debt of around \$208 million in 1998–99. However, actual borrowings had fallen to \$140 million at 30 June 1999, offset by liquid assets of \$36 million, leaving net borrowings of \$104 million compared to about \$154 million at 30 June 1996.

background of falling interest rates and generally increased loan affordability. ABC cash holdings declined from \$50 million to \$36 million over the period.

46. The ABC said that its cash holdings were already committed. The ABC also advised that it recorded more than \$80 million in abnormal gross revenue items during 1996–97 and 1997–98, covering the writeback of superannuation liability and the capitalisation of assets, such as its music library and the sound and film libraries. It stated that the increase in assets during 1997–98 was due to revaluations, resulting from changes in government accounting policy, totalling almost \$149 million.

47. The ABC has acknowledged that it does have a greater capacity to borrow than at the time of the government’s decision on digital funding. However, it has a policy of only borrowing for projects that are self-funding, either through producing a revenue stream or ongoing cost savings, so that its borrowing program does not impinge on ABC operational activities. Sinking Funds are established to quarantine any operational savings for debt servicing for the duration of the debt. The ABC considers that any borrowings it undertakes for digital conversion are on behalf of the government. The ANAO noted that the ABC proposes to use its borrowing capacity to fund a new building at Ultimo as part of its co-location strategy, which is likely to reduce the ABC’s capacity to borrow funds for its digital conversion. Although a matter for the ABC Board, the ANAO also noted that the ABC has not considered providing a greater contribution to the costs of digital conversion by consolidating or refinancing its loans.

48. The ABC also commented that, in its view, any consideration of windfall gains should only include revenues that are a direct result of the conversion to digital broadcasting or result from the property rationalisation strategy.

49. Improvements have also occurred in the financial environment in which the SBS has operated since the assumptions underpinning the government decision on Phase 1 funding were made. These include a significant rise in the cash held by the SBS (up from \$0.6 million to \$11.7 million, which is \$5.7 million higher than budgeted at 30 June 1999); increases in the levels of assets, equity and annual surpluses; together with a decrease of around \$12 million in net borrowings, against a background of falling interest rates and generally increased loan affordability. Taken together with the rise of some \$10 million in its annual advertising and other income, these increases suggest an improved capacity for the SBS to contribute to the costs of digital conversion.

50. The SBS disagrees with this assessment. It acknowledges that its financial position is improving, but considers that improvements were required from the previous levels of liquidity. The SBS considers that its current debt level is too high and the current environment does not enable it to take on further debt to fund digital purchases. The SBS also said that its significant cash reserves are temporary in nature and a large proportion is for non-discretionary expenditure that will occur in the near future. The SBS also advised that the sale and lease-back of the Artarmon property was not a viable source of funding for digital conversion. The ANAO recognises that these are factors the SBS Board would need to take into account in determining the SBS's expenditure priorities and borrowing capacity.

51. The ANAO recognises that the financial management of the national broadcasters is a matter for their respective boards and management. Within the agreed objectives of the audit, it is not the role of the ANAO to comment on the boards' strategies and expenditure priorities.

Audit Findings and Conclusions

1. Introduction

This chapter outlines background information on the audit, the reasons it was conducted and the objectives, scope and methodology of the audit. It also provides an overview of digital broadcasting and its introduction in Australia.

Background

1.1 The Mansfield Report¹² of January 1997 into the ABC recommended that, when the cost of the ABC's digital conversion was known, the government consider the need for a modest one-off grant towards the end of the century to assist in financing the upgrade.

1.2 In 1997, the ABC and SBS developed digital conversion strategies that were forwarded with a request for budget funding to the government for consideration. The ABC had a two-phase strategy for digital conversion, the first phase of which was a five-year plan for the purchase of digital production equipment; conversion of its studios; the conversion of archive material; and enhancement of regional services.¹³ In November 1997, the ABC estimated that implementation of Phase 1 from 1998–99 would cost \$107.5 million. This was revised to \$110 million in March 1998, \$118 million in February 1999 and \$119 million in June 1999, including interest on moneys to be borrowed to purchase its digital equipment. The SBS also developed a strategy in August 1997 for Phase 1 of the conversion of its television and radio production and internal transmission facilities from analogue to digital, which it estimated would cost \$21.5 million over five years.¹⁴

1.3 The government commissioned a report from Arthur Andersen Corporate Finance (AACF) which assessed the ABC and SBS's digital strategies and costs. The AACF's assessment was that, within the limits

¹² *The challenge of a better ABC*, Mr Bob Mansfield, January 1997.

¹³ Under Phase 2 the ABC will purchase equipment required for exchanging program material between ABC centres and transmitting signals from the ABC to the National Transmission Network (NTN) for broadcasting to the public. The main focus of Phase 2 will be Digital Terrestrial Television Broadcasting. A third phase was identified for the (non-ABC) costs associated with transmission from NTN sites to the audience. In December 1998 the ABC regarded Phase 3 as covering the anticipated costs it will incur for High Definition Television (HDTV) that were initially beyond the five years of Phase 1. In June 1999 the ABC brought forward into Phase 2, the HDTV production systems that previously fell outside the five-year planning period requested by the government.

¹⁴ The SBS Phase 1 strategy, like the ABC's, does not cover signal transmission to the public in digital. This will be covered under Phase 2. Phase 2 also covers program distribution from the playout centre at the SBS headquarters at Artarmon in Sydney to the transmitters; playout and encoding equipment; and studio equipment used for the production and editing of HDTV content and the systems that schedule program material and advertising content.

of the information available at the time, these strategies and costs appeared reasonable. However, the report noted, in March 1998, that the contribution from the ABC to its digital upgrade was not yet settled.

1.4 In March 1998, the government announced a digital technology policy under which Digital Terrestrial Television Broadcasting (DTTB) would be required in metropolitan areas by 1 January 2001 and in regional areas over the following three years, so that all of Australia would have access by 1 January 2004. Broadcasters are also required to maintain their existing services in analogue format for an eight-year simulcast period¹⁵ that will enable viewers to make the transition to digital by 2009 for metropolitan areas and 2012 for regional areas. This will involve substantial additional costs for the ABC and SBS. In mid-1998 the enabling legislation was passed in the form of the *Television Broadcasting Services (Digital Conversion) Act 1998* and the *Datacasting Charge (Imposition) Act 1998*.

1.5 The government considered the ABC's and SBS's strategic plans in the context of the 1998–99 Budget and the estimated costs of their moving to a digital broadcasting environment. Digital technology is still very new and there are many unresolved policy and technical issues, such as spectrum planning requirements and the availability of equipment which will affect the overall costs.

1.6 Given the many uncertainties associated with digital conversion, the government decided, in April 1998, to provide the ABC and SBS with funding support (\$20 million for the ABC to enable it to undertake off-Budget borrowings and \$16.9 million for the SBS) over five years, to assist with Phase 1 (facilities and equipment) of their digital conversion strategies. The government also decided that it would request the Auditor-General to examine Phase 1 digital conversion expenditures after two years, to provide input for its decisions on additional funding.¹⁶ Further consideration would be given to the need for additional funding when greater certainty existed about the proceeds from property rationalisations, the costs of subsequent digital conversion phases, and in the light of the report from the Auditor-General.

1.7 The ABC and SBS digital strategies proposed that the national broadcasters would also contribute to the costs of conversion. The government agreed that the ABC would provide a capital contribution of \$30 million over five years in addition to the proceeds from the second

¹⁵ The government has also made provision for the eight-year simulcast period to be adjusted through regulations depending on needs of particular areas and takeup factors.

¹⁶ For Phases 2 and 3 for the ABC and for Phase 2 for the SBS.

tranche of sales under the rationalisation of its property portfolio, which in 1997 were forecast at \$36 million. The SBS would make a capital contribution of \$3.9 million over five years, to be supplemented by the proceeds from the sale to the purchasers of the National Transmission Network of its transmitter site at Craigieburn in Victoria, estimated in 1997 at \$0.75 million.

1.8 In July 1998, the Chairman of the ABC wrote to the Minister requesting an early decision about the balance of the funds to be provided by the government. The ABC stated that it would need to take on significant borrowings if it were to proceed with its digital conversion strategy, which it was reluctant to do in the absence of greater certainty about how the outstanding debt would be met. In August 1998, the Chairman advised the Minister that estimated borrowings for Phase 1 would result in an outstanding debt at the end of five years of some \$31 million. He requested that all debt management and financing costs associated with any borrowings required to be undertaken by the ABC for Phase 1 be met by the government.

1.9 In October 1998, in a letter to the Minister for Communications, the Prime Minister agreed that the Commonwealth would cover the outstanding debt in relation to Phase 1 of the ABC's digital conversion plans at the end of the five-year conversion period (that is, 2002–03). It was agreed that any windfall gains must be used to repay Phase 1 debt. The government also decided to bring forward its request for the Auditor-General to assess financial aspects of the ABC and SBS digital conversion strategies.

1.10 Against this background, in November 1998 the Minister for Communications wrote to convey the government's request that the Auditor-General undertake an assessment of the actual costs of digital conversion; sources of funds applied; and the efficiency with which the funds had been used before the government considered further funding to the ABC and SBS for their respective conversion programs. The Auditor-General agreed to undertake a general performance audit under Section 18 of the *Auditor-General Act 1997*.

Digital broadcasting

1.11 The conversion of broadcasting from analogue to digital transmission marks a significant shift in communications technology. Since its introduction into Australia in 1956, television broadcasting has relied on analogue transmission technology, which converts sound and pictures into continuously varying electric signals. Analogue has certain technical limitations as the signal can be easily distorted. It uses the full bandwidth

of the spectrum and requires a clear delivery path from the broadcaster to the viewer.

1.12 The introduction of digital technology removes the constraints of the old analogue system. Although both systems use 7 MHz of spectrum, the digital signal occupies less space on the spectrum, is of a higher quality and does not need adjacent channels to be kept free to remove the possibility of interference between channels. Digital technology also offers the possibility of a wider range of services for the viewer including High Definition Television (HDTV), multi-channelling and enhanced data transmission.

1.13 For broadcasters and their audiences, the introduction of digital technology breaks down the traditional barriers between radio, television and online computing; transforms the broadcasting environment; and brings both new opportunities and new costs. Digital Radio Broadcasting (DRB), like the television equivalent, has the potential to offer broadcasters a number of opportunities to extend programming beyond current services. These opportunities include new audio services, datacasting, and ancillary program information that combine text and visual information (especially graphics).¹⁷

Digital broadcasting in Australia

1.14 In March 1998, the government announced the introduction of digital broadcasting in Australia. The principal elements of the policy include the following requirements:

- Free-To-Air (FTA) broadcasters (the ABC, SBS and commercial stations) will be required to begin DTTB in metropolitan areas by 1 January 2001 and in regional areas from that date onwards, so that all areas of Australia will have access by 1 January 2004;
- FTA broadcasters will also be required to maintain their existing service in analogue format for an eight-year simulcast period to enable viewers to make the transition. They will be loaned 7 MHz of spectrum without charge which is to be returned at the close of the period;
- FTA broadcasters must begin DTTB transmissions by the start-up date or they will be required to return loaned digital spectrum to the Commonwealth;
- FTA broadcasters may use the portion of their loaned digital spectrum not utilised for DTTB to provide data-casting services but will be charged fees for providing these services on a similar basis to data-casting service providers;

¹⁷ ABC Digital Content Strategy—December 1998, p.57

- broadcasting spectrum, which is not required by the FTA broadcasters for digital conversion, will be allocated on a competitive basis for providing data-casting services commencing at the same time as the transmission of DTTB. Existing FTA broadcasters will not be able to bid for this additional spectrum;
- national broadcasters (the ABC and SBS) will be able to provide enhanced programming. A review will decide the extent to which they should also be allowed to broadcast multi-channel programming which is non-commercial and in line with their Charter obligations; and
- the ABC and SBS will be able to use or sublease their residual DTTB capacity to transmit data-casting services in accordance with competitive neutrality principles and with a revenue sharing agreement negotiated with the Commonwealth.

Reviews

1.15 The legislation requires several policy reviews to be conducted by 1 January 2000, including:

- the scoping of datacasting services;
- the provision of enhanced services (such as enabling a viewer to click on an icon to obtain more details about the program being watched);
- reviews under Part 4 of Schedule 4 of the new legislation including HDTV formats, goals and targets, and captioning standards;
- multi-channelling by public broadcasters;
- provision of new services in under-served regional licence areas;
- regulatory arrangements to apply to the allocation of spectrum in the broadcasting service bands for datacasting, including the transmission of community television in digital mode in the datacasting spectrum;
- transmission of digital FTA services on pay television; and
- convergence between broadcast services and other services.

1.16 Decisions made on these reviews will affect the overall costs of digital conversion.

1.17 The introduction and implementation of DTTB in Australia was enacted through the *Television Broadcasting Services (Digital Conversion) Act 1998* and the *Datacasting Charge (Imposition) Act 1998* which both came into operation on 27 July 1998. There was no legislation at the time of the audit covering the introduction of DRB.

Audit objectives, scope and focus

Audit objectives

1.18 The purpose of this limited scope performance audit was to assess a range of financial issues associated with the ABC and SBS conversion to digital broadcasting. The objectives were agreed in correspondence between the Auditor-General and the Minister in February 1999. The Minister also advised that the digital strategies provided to the government by the ABC and SBS in late 1997 should form the baseline for the audit. Specifically the audit examined:

- the estimates prepared by the ABC and SBS for the costs associated with Phase 1 of the conversion and the quality assurance processes adopted to give confidence that they reflect the minimum reasonable costs of the conversion to digital broadcasting;
- expenditures to date by the ABC and SBS in Phase 1 to determine the extent to which they conform with the terms of the government's decision to provide funding for the conversion to digital broadcasting;
- the estimated and actual quantum and timing of funds generated from the ABC and SBS property relocation strategies and other sources of funds to ensure all net funding from property rationalisations has been directed to digital conversion and identify any significant variations from estimates for the funds obtained from property and other sources; and
- the payment and financing arrangements in place for the purchase or lease of digital conversion equipment to ascertain whether they are designed to minimise the call on Budget funds.

Audit scope and focus

1.19 The audit concentrated on the costs and funding of the conversion to digital broadcasting rather than issues of engineering design or property relocation strategies, which were outside the audit scope. In scoping the audit, the ANAO took into consideration the findings of the AACF reports to the government and a number of external expert reviews commissioned by the national broadcasters of their asset portfolios and borrowings. Further, the ANAO noted the reference by the Prime Minister¹⁸ to the ABC's willingness for the Auditor-General to assess the costs of conversion, the efficiency of funds utilisation and the revenue

¹⁸ Correspondence dated 26 October 1998 from the Prime Minister to the Minister. The Managing Director of the ABC had suggested to the Department in March 1998 that the Auditor-General provide independent verification of the costs of the ABC's digital conversion at the end of Year Three.

sources (including additional borrowings) available to the ABC to contribute to the Phase 1 debt.

1.20 The audit has identified a number of revenue sources that could be applied to the costs of digital conversion. However, the ANAO recognises that the financial management of the national broadcasters is a matter for their respective boards and management. Within the agreed objectives of the audit, it is not the role of the ANAO to comment on the boards' strategies and expenditure priorities.

Audit methodology

1.21 The audit was undertaken using a mix of on-site inspections of facilities and operations at the Sydney premises of the ABC and SBS; interviews with management and operational personnel; and a review of documents, files and previous reports. It also included sample testing of financial transactions and assets, together with analyses of estimates, budgets, expenditures and operational and institutional arrangements.

1.22 Discussions were also held in Canberra with representatives of the Minister's Office to clarify the proposed audit objectives. In addition, discussions were held during the audit with the Department of Communications, Information Technology and the Arts and the Department of Finance and Administration.

1.23 The audit was conducted in accordance with ANAO auditing standards. The audit commenced in January 1999, with fieldwork conducted through to August 1999. The cost of the audit was \$220 000.

2. ABC digital conversion estimates

This chapter provides background information about the ABC and its plans for digital conversion. It also examines the estimates prepared by the ABC for the costs associated with Phase 1 of the conversion and the quality assurance processes adopted to give confidence that they reflect the minimum reasonable costs of the conversion to digital broadcasting.

The ABC

2.1 The ABC is one of two national broadcasters operating in Australia. The Corporation is located in the Communications, Information Technology and the Arts portfolio, with responsibility for its oversight entrusted to a Board of Directors. The functions of the Corporation defined in its Charter include:

... to provide within Australia innovative and comprehensive broadcasting services of a high standard as part of the Australian broadcasting system consisting of national, commercial and public sectors, and to provide:

- a) broadcasting programs that contribute to a sense of national identity and inform and entertain, and reflect the cultural diversity of the Australian community; and*
- b) broadcasting programs of an educational nature.¹⁹*

2.2 The ABC receives its major income through annual government appropriations under a triennial funding arrangement. In 1999–2000, the appropriations were \$632 million and other income totalling about \$123 million is expected to be received from a variety of sources including merchandising, co-productions, program sales, interest and royalties. The ABC had around 4200 staff at 30 June 1999, based in all capital cities and 49 other locations throughout Australia and 16 overseas locations. More than half the staff is in NSW with 1100 in the 24 buildings comprising the Gore Hill complex in Sydney and 900 staff in the purpose-built Ultimo premises.

2.3 With the announcement of the ‘One ABC’²⁰ structure in December 1996, the ABC replaced the previous media-based divisions with a

¹⁹ The Charter of the ABC is contained in section 6 of the *Australian Broadcasting Corporation Act 1983*.

²⁰ A key initiative of ‘One ABC’ is to collocate radio, television and online reporting and production staff for particular content areas such as News.

structure comprising National Networks, Regional Services, News and Current Affairs, Program Production and three support groups.

The ABC's digital conversion plans

2.4 The ABC developed a staged approach for the conversion of its analogue facilities to digital technology, at the centre of which is a five-year digital conversion strategy for Phase 1. This strategy was provided to the government in November 1997. During this first phase the ABC will purchase digital production equipment, convert its existing analogue radio and television studios; convert its archive material; and enhance its regional services.²¹

2.5 Under Phase 2 the ABC will purchase digital links and other equipment required for exchanging program material between ABC centres and to transmit signals from the ABC to the National Transmission Network²² (NTN) for broadcasting to the public. The main focus of Phase 2 will be DTTB as, aside from some test broadcasting, DRB is not expected to begin before about 2003. HDTV is expected to operate only on a limited basis before 2003. There will also be substantial transmission operating costs associated with running the digital and analogue broadcasting networks concurrently. In July 1999, the ABC submitted its Phase 2 costings to government, which total \$74 million over four years from 1999–2000 for delivery of DTTB and also identified additional operational costs of \$78 million per annum that the ABC will incur once the roll-out is complete.

2.6 Phase 3 was initially designated to cover the additional costs that will be incurred for transmission from the NTN sites to the audiences (until the sale of the NTN in March 1999 the ABC was not funded or responsible for transmission costs). However, in December 1998, the ABC included the anticipated costs of HDTV as part of Phase 3. The Board was advised that these had not been included in the November 1997 request to the government²³ because the ABC expected HDTV expenditure to fall outside the Phase 2 time horizon and government policy on HDTV was still to be determined. The ABC's July 1999 Phase 2 submission included expenditure on the HDTV production systems that have been brought forward.

²¹ This involves enhancing the capacity of existing ABC regional stations to produce local programs and to feed material back into the capital cities for inclusion in national and State-wide programming.

²² The sale of the National Transmission Network was announced by the government in March 1999. The network consists of 561 towers around Australia and is used by the ABC, SBS and regional broadcasters for transmission of their radio and television signals.

²³ Which included estimates of Phase 2 costings.

What were the original estimates?

2.7 The Mansfield Review recommended in early 1997 that, when the costs of the ABC's digital conversion were known, the government consider the need for a modest, one-off grant to assist in financing the upgrade.²⁴ In November 1997, the ABC estimated that it required \$107.5 million over five years for expenditure on Phase 1 of its conversion to digital. It proposed to contribute \$66 million from its own resources (\$36 million from property sales plus \$30 million from its capital budget that it would normally have spent replacing analogue equipment). The remaining \$41.5 million was requested from the government.²⁵ Table 1 shows the figures submitted at the time.

Table 1

ABC digital conversion estimates—November 1997 (\$ million)

Expenditure		98-99	99-00	00-01	01-02	02-03	TOTAL
	Extension of Regional Services	7.5	5.9	5.0	0.9	0.8	20.1
	Archives Initiative	3.4	1.9	1.9	1.9	1.9	11.0
	Preparation for DTTB and DRB	19.3	18.0	24.9	9.2	5.0	76.4
	Planned Expenditure on Digital Conversion (Phase 1 only)	30.2	25.8	31.8	12.0	7.7	107.5
Sources of Funds							
	Revenue from property sales ^(a)	-	-	12.0	12.0	12.0	36.0
	ABC Capital Contributions	6.0	6.0	6.0	6.0	6.0	30.0
Balance	Government Funding Requested	24.2	19.8	13.8	-6.0	-10.3	41.5

Source: ABC Board Papers and *The Mansfield Review Recommendations: Additional ABC Input to the Minister for Communications, the Information Economy and the Arts—November 1997*.

Note (a) In November 1997 the specific properties to be sold by the ABC had not been identified. The ABC advised the ANAO that indicative figures for the timing of property sales proceeds were therefore used.

2.8 AACF was commissioned by the government to review the ABC's digital conversion strategy and, in March 1998, reported that some \$11 million of the proposed costs of extending regional services may be considered as enhancements and were not essential for digital conversion. A further reduction of \$10.6 million was also raised by AACF based on the Mansfield Review recommendation that the ABC outsource the majority of its non-news and current affairs production over a three-year period.

²⁴ Op cit, Mansfield Review, p.8.

²⁵ The ABC also estimated that it would require an additional \$70 million for Phase 2, of which some \$40 million would be required over the last three years of the five-year Phase 1 strategy.

2.9 In correspondence to the Department dated 27 March 1998, the ABC included Phase 1 costs of \$110 million. However, the ANAO noted that the government funding decision made on 1 April 1998 was based on the figures provided in the ABC's November 1997 submission (with Phase 1 costs of \$107.5 million).

2.10 In April 1998, the government decided to provide funding to the ABC of \$20 million (indexed to \$20.8 million) over the five years from 1998–99 to assist with off-Budget borrowing to fund its digital Phase 1 upgrade. Furthermore, additional funding for digital conversion would be considered when there was greater certainty about the proceeds from property rationalisations and the costs of Phase 2 and in light of a report to be requested from the Auditor-General. In October 1998, the Prime Minister agreed that the Commonwealth would cover the expected outstanding Phase 1 debt at the end of five years. In correspondence to the Auditor-General in February 1999, the Minister advised that, in agreeing to meet the ABC's Phase 1 debt at the end of the five year period, the government considered that Phase 1 meant the ABC's digital strategy submitted to the government in late 1997. He added that this included the enhanced component identified by AACF in its report to the government in early 1998.

2.11 As discussed in Chapter 3, the ABC spent about \$3.77 million from its first tranche property rationalisation proceeds on pre-Phase 1 digital expenditure in 1997–98. The ABC has agreed to contribute \$6 million per annum from its capital expenditure allocations towards the costs of digital conversion for the five years commencing in 1998–99.

How were the estimates prepared?

2.12 The ABC developed its overall strategy for digital television broadcasting following a series of workshops involving all areas of the Corporation. It already had some experience in converting the Gore Hill pay-TV facilities²⁶ to digital and built upon the list of equipment required for these. Price lists and estimates from existing and potential suppliers were used by the ABC in the compilation of the estimates, where the required digital equipment was already, or would soon be, available. The ABC cross-checked its list of required technical facilities against a detailed list of HDTV equipment produced by the Australian broadcast

²⁶ The ABC held a majority shareholding in Australian Information Media Pty Ltd (AIM), a joint venture between the ABC, Fairfax and Cox Communications. AIM ceased business operations in September 1996 when it could not secure a viable distribution arrangement with a subscription television carrier. The ABC subsequently acquired the major assets of the joint venture, including the digital facilities in the Frank Dixon Building at Gore Hill.

industry. A specialist from Price Waterhouse who had audited the digital strategies of broadcasters in the United Kingdom was also engaged to review the estimates prior to submission to the government. Prices were not adjusted for inflation or for any subsequent fluctuations in foreign exchange rates.

2.13 The ABC stated that it attempted some broad comparisons with United States and other overseas broadcasters' costings for digital conversion but differences between markets tended to invalidate any direct comparisons. The AACF reports also commented on comparative experience with digital conversion for commercial broadcasters in Australia, but did not include costings.²⁷

2.14 All estimates, including digital radio requirements, were centrally coordinated and compiled through the Technology, Strategy and Development Branch of the ABC.

2.15 There was no master list of digital equipment or required facilities at the time of the preparation of the original estimates. The ABC has advised that its digital strategy is outcomes-based and does not focus on a simply one-for-one replacement of analogue equipment as it includes, for example, a regional enhancement component which, as noted above, has been accepted by the government as part of Phase 1.

2.16 The project plan includes a time-line for the various stages of the conversion. This encompasses planning, preparation of requests for tenders, evaluation, purchasing and delivery in time for installation. The ABC advised that equipment purchases are timed to meet requirements and minimise storage.

2.17 The ANAO noted that the AACF review team included a specialist from the United Kingdom with broadcasting industry expertise. Although the AACF final report contained a number of important qualifications, it endorsed the overall quality assurance processes undertaken by the ABC in preparing its estimates and concluded that:

*Based on available information, the cost and specification of equipment proposed by the ABC broadly does not appear inappropriate.*²⁸

2.18 The government accepted the AACF conclusions and endorsed the strategy and Phase 1 costings submitted by the ABC.

²⁷ AACF March 1998 Final Report, p.68 and December 1997 Interim Report, p.50.

²⁸ AACF Final Report, p.10.

Have the estimates been revised?

2.19 The ANAO was advised that as new information became available there was ongoing update of equipment prices in the listing of the ABC's digital equipment requirements. These variations have not been reflected in revised estimates.²⁹ The ABC advised that it is committed to achieving Phase 1 outcomes within its budget of \$110 million. As a consequence of the ongoing changes, the ABC (and the ANAO) could not directly reconcile the elements in the current listing (which originated in October 1998) to figures in the November 1997 submission.

2.20 Following government funding announced in the May 1998 Budget, revised estimates of the costs of digital conversion were put to the ABC Board in June 1998. In August 1998, the ABC wrote to the Minister requesting that the government meet the cost of all debt management and financing costs associated with any borrowings by the ABC for Phase 1, including the expected outstanding debt at the end of five years of \$31 million. In October 1998, the Prime Minister agreed that the Commonwealth would cover the outstanding debt at the end of the five years. In making this commitment, the government stated that any windfall gains accruing to the ABC from property rationalisation or other relevant revenue sources must be used to repay Phase 1 debt.

Table 2

ABC revised Phase 1 digital conversion estimates—June 1999 (\$ million)

Expenditure	98-99	99-00	00-01	01-02	02-03	TOTAL
Planned Expenditure on Digital Conversion (Phase 1 only)	5.5	42.9	35.8	22.5	3.3	110.0
Interest at 8 per cent ^(a)	-	0.4	2.6	3.6	2.5	9.2
Total						119.0
Sources of Funds						
Revenue from Property Sales	-	2.0	-	34.0	-	36.0
ABC Capital Contributions	6.0	6.0	6.0	6.0	6.0	30.0
Initial Government Allocation	4.0	4.1	4.2	4.2	4.3	20.8
Proposed cost to Government for Phase 1 outstanding debt	-	-	-	-	32.0	32.0
Total						119.0

Source: ABC Board Papers.

Note ^(a) This is based on an average interest rate of 8 per cent over the five years. However, over 1998-99, the ABC paid an average of 5.95 per cent on its total borrowings.

²⁹ That is, the revised estimates for planned Phase 1 expenditure (excluding interest) have remained at \$110 million, even though the listing (which from October 1998 only includes costs for television) indicates that spending will increase from \$130 million at October 1998 to \$160 million at August 1999. The ABC also advised that since the Phase 1 estimate of \$107.5 million was produced, the ABC has estimated that about 75 per cent of the Phase 1 costs are included in that total, but these figures will change as the real costs of predicted equipment become available.

2.21 The ABC Board approved revised estimates in February 1999, with subsequent revisions to the timing of Phase 1 expenditures approved in June 1999. These are shown in Table 2.

2.22 The timing of planned expenditure by the ABC has varied with less to be spent in 1998–99 and more in 1999–00 to 2001–02. The bulk of the property rationalisation proceeds are now expected in 2001–02 rather than being spread equally over three years (as estimated before the specific sites to be sold were identified). The ANAO calculated that this change has marginally increased the Net Present Value of the expected property proceeds by \$0.23 million.³⁰

2.23 As at June 1999, the estimated total cost of Phase 1 had risen to \$110 million plus a component of about \$9 million covering interest for expected borrowings as a consequence of the government’s approved borrowing strategy. Although forecast total expenditure increased by \$2.5 million, the estimated total contribution sought directly from the government³¹ has risen by some \$11.5 million,³² from \$41.5 million to \$53 million, including the estimated \$9 million interest component (Table 3 refers).³³ Offsetting this, there have been increases in the expected proceeds from property rationalisation proceeds that are not reflected in Table 2 above. These are discussed separately in Chapter 4.

Table 3

Increases in ABC Phase 1 digital conversion estimates—November 1997 to June 1999 (\$ million)

	<i>Nov 1997</i>	<i>June 1999</i>	<i>Increase</i>
Cost of Phase 1	107.5	110.0	2.5
Interest	-	9.0	9.0
Total Cost	107.5	119.0	11.5
Government Funding Requested	41.5	-	-
Government Funding Approved	-	20.8	-
Additional Funding (Balance of Loan)	-	32.2	-
Proposed Total Government Funding	41.5	53.0	11.5

Source: ABC Board Papers.

³⁰ At a 10 per cent discount rate the NPV increased from \$27 129 293 to \$27 362 884.

³¹ Government also contributes indirectly through annual appropriations to the ABC.

³² Comprising \$2.5 million increase in Phase 1 proposed capital expenditure plus interest costs of some \$9 million.

³³ Comprising the initial allocation of \$20.8 million and the balance of \$32.2 million covering the expected debt outstanding at the end of Year Five.

Are the estimates reasonable?

2.24 In addressing this question the ANAO sought to minimise any duplication of the earlier work done by AACF.³⁴ The ANAO (and AACF) did not attempt to verify whether the mix of equipment being converted to digital was appropriate. The government had agreed that the quantity and mix of digital equipment reflected in the broadcasters' proposals were acceptable and the Auditor-General advised the Minister, in responding to his request, that the audit would not cover technical issues of engineering design.

ABC and SBS comparative contributions

2.25 The ABC proposed to contribute \$66 million over five years or about 11.1 per cent of its 1998–99 income whereas the SBS proposed to contribute about \$4.65 million or 3.6 per cent of its 1998–99 income over the same period (revised to \$4.85 million or 3.8 per cent in June 1999.) The ANAO notes the limited property holdings of the SBS compared with the ABC.

2.26 The ABC's November 1997 submission to the government stated that the ABC spends some \$12.5 million per annum on technical replacements. The submission proposed that the ABC contribute \$6 million per annum for the five years of Phase 1 towards the cost of digital conversion. At the time of the audit, the ABC's contribution to the cost of digital conversion beyond this point had not been determined.

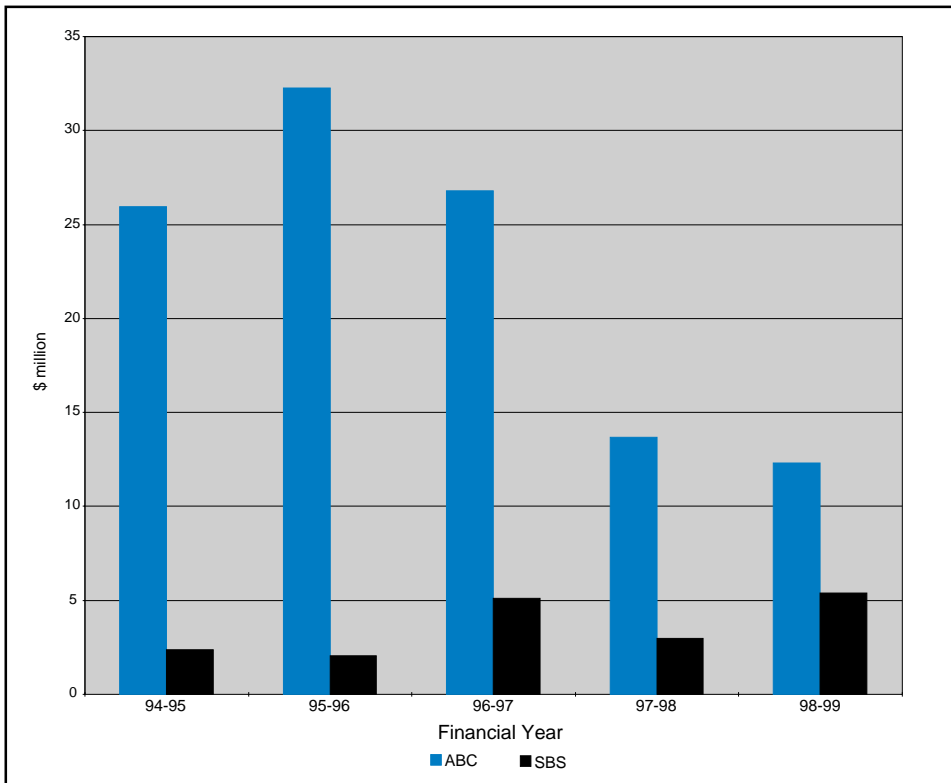
2.27 The ANAO sought to ascertain whether any trends were apparent in the level of spending by both the ABC and SBS on plant and equipment over the last few years. Figure 1 below indicates that expenditure by the SBS has been relatively stable but expenditure by the ABC has declined in recent years. The ANAO recognises that capital expenditure on replacement of technical equipment will vary from year to year. However, a significant reduction may have implications for the cost to the government of the residual Phase 1 debt or capital expenditure in later years, as the overall age of equipment increases, requiring a larger injection of funds in the future.

2.28 The ABC advised that part of the \$55 million reduction in 1997–98 government appropriations was reflected in the lower capital expenditure for the period.

³⁴ AACF undertook a four-step approach: Step 1 assessed the reasonableness of the methodology adopted to prepare the ABC digital expenditure plans. Step 2 identified the material cost categories in the plans. Step 3 identified the main cost components in the selected categories. Step 4 verified the costs to supplier quotes, internal costing reports, asset register and through discussion with engineers. (See page 46 of AACF report of 8 December 1997).

Figure 1

ABC and SBS annual expenditure on plant and equipment



Source: ANAO analyses of ABC and SBS Annual Reports and budget papers.

Note: ABC 1998–99 figure is a forecast.

Audit conclusions

2.29 The ABC digital conversion strategy submitted to the government in November 1997 forms the basis of its current implementation. However, the strategy was outcomes-based and did not contain a consolidated master-list of the ABC’s equipment requirements against which subsequent revisions and purchases can be easily checked. The ABC was of the view that it was not in a position at that time to prepare a detailed list of its digital requirements. The ABC and the ANAO could not reconcile the elements of a listing of equipment requirements, which originated in October 1998, to the approved digital strategy.

2.30 The ANAO noted the previous involvement and technical expertise of AACF in assessing the ABC digital conversion strategy. In the light of that involvement, advice given to the government and its acceptance of the scope of the ABC’s strategy and associated costings, the ANAO concluded that the overall processes in compiling the estimates gave

confidence that they reflected the minimum reasonable costs of conversion.

2.31 The cost of the Phase 1 conversion has risen on initial estimates and the ABC has continued to revise the timing of its estimates, which were forwarded to the government at the beginning of July 1999. The ABC advised that it is committed to achieving Phase 1 outcomes within its budget of \$110 million.

3. ABC digital conversion expenditure

This chapter examines the actual expenditure to 30 June 1999 by the ABC under Phase 1 and the extent to which it conforms with the terms of the government's decision to provide funding for the conversion to digital broadcasting.

How much has the ABC spent to date on digital conversion?

3.1 Since 1 July 1997 the ABC has spent \$9 million and committed a further \$0.08 million on digital conversion as at 30 June 1999. Of this expenditure figure \$3.77 million represents expenditure on digital projects during 1997–98 that the ABC considers to be outside the Phase 1 funding approved by the government. In the absence of a reconcilable list of equipment that makes up the ABC's Phase 1 strategy it is not possible to confirm this one way or the other. ABC expenditure on digital conversion during 1998–99 was \$5.23 million (see Table 4).

Table 4

ABC digital conversion expenditure 1998–99 and commitments at 30 June 1999 (\$ million)

	<i>Actual</i>	<i>Committed</i>	<i>Total</i>
Radio	0.36	-	0.36
Television	1.17	0.08	1.25
Multimedia	0.14	-	0.14
News/Local production at regional centres	1.85	-	1.85
Other infrastructure	0.83	-	0.83
TV archives	0.01	-	0.01
Information technology	0.88	-	0.88
Totals	5.23	0.08	5.31

Source: ABC Papers

3.2 The digital expenditure for 1998–99 of around \$5.2 million is considerably less than the original estimate of \$30.2 million envisaged in November 1997 in the submission to the government and a \$15 million revised estimate provided to the ABC Board in February 1999.

Is all the expenditure related to digital conversion?

3.3 As at 30 June 1999, the ABC had spent some 4.6 per cent of the total planned expenditure of \$110 million for Phase 1. The ABC records expenditure on digital projects in designated accounts. Sample testing of these accounts by the ANAO of all transactions of \$10 000 and over, in 1998–99, confirmed that the expenditure was consistent with the digital conversion strategies forwarded to, and approved by, the government. However, the ANAO noted that some \$0.88 million included in the ABC's expenditure related to the leasing of personal computers and associated software. It was also noted that in relation to this type of expenditure AACF commented in March 1998 that it:

. . . involves the upgrade of the internal communication network via a multimedia capable personal computer with text editing equipment and audio/video editing software. This capability complements the digitisation process but does not form part of the conversion process.³⁵

Due to the relatively limited expenditure and its dispersal across numerous ABC sites, the ANAO testing did not extend to tracing and physical sighting of assets acquired (as was performed for SBS digital purchases – see paragraph 7.3).

3.4 The ABC advised the ANAO that it has delayed its Phase 1 investment pending resolution of the final government policy on DTTB. It stated that a considerable amount of planning work is underway to allow integration of digital conversion with property rationalisation across Australia to ensure that the ABC will meet the 1 January 2001 digital start-date. It added that the ABC strategy has been to seek the most cost-effective conversion through bulk purchase and close coordination of digital conversion of internal plant under Phase 1 with the implementation of digital delivery to the public under Phase 2.

Are adequate systems in place to identify all expenditure related to digital conversion?

3.5 As indicated above the ABC records its digital expenditure in specially designated accounts. The accounts form part of the ABC's SAP³⁶ financial management system that began operating in October 1998. There is also some \$1.2 million of digital expenditure for the period July to October 1998 recorded in the predecessor financial system, which has been rolled into the SAP system at a summary level only.

³⁵ AACF March 1998 Final Report, p.64.

³⁶ SAP is a propriety brand name.

3.6 The SAP system includes an investment project management module which provides a good framework for controlling and recording both the ABC's expenditure of digital conversion funds and the proceeds from its asset disposals program (see Figure 2). Budgets are set and expenditures recorded for each project under the various digital conversion programs within Phases 1 and 2. These figures flow through to a separate profit centre for each Phase, together with the details of borrowings for digital conversion, related interest payments and receipts as well as the proceeds of asset sales.

3.7 The ANAO encountered some difficulties with the ABC's recording of transactions in SAP because of missing or inadequate descriptions of purchases. Some digital expenditure transactions had no text descriptions entered or the entry simply recorded a requisition or invoice number. This necessitated additional effort by ANAO in tracing the expenditures back to source documentation to establish the nature of each purchase.

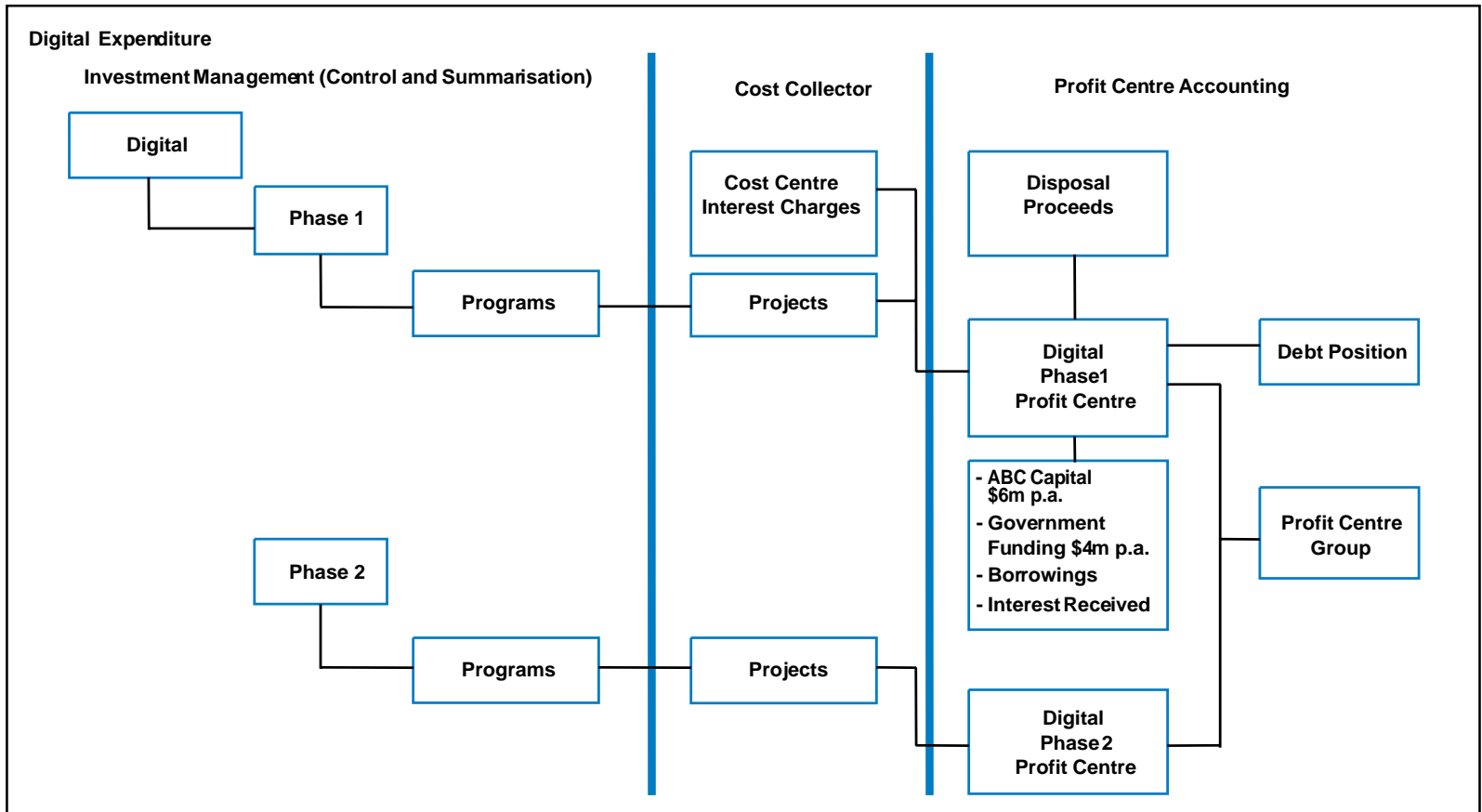
3.8 The ANAO suggested that the ABC make particular efforts to ensure adequate descriptions are entered into the new financial management information system in future for each expenditure transaction. This will make the task of monitoring digital expenditure easier for the ABC itself and also facilitate the selection of appropriate samples of digital expenditures in the future for any periodic review by the ANAO.

Audit conclusions

3.9 The ABC spent \$5.2 million on digital conversion during 1998–99, less than five per cent of the total planned for Phase 1. This is significantly lower than the \$30.2 million expenditure originally estimated for 1998–99. Sample testing of purchase transactions confirmed that this limited expenditure was consistent with the ABC's digital conversion strategy forwarded to, and approved by, the government.

3.10 The ABC's new SAP financial management system, overall, provides a good framework for controlling and recording the ABC's digital expenditure and also asset disposals. However, the ANAO suggested that the ABC's input controls over descriptions entered into the system be improved.

Figure 2
ABC digital conversion investment management framework



ABC digital conversion expenditure

4. ABC property and other revenue

This chapter examines the ABC's property strategy and the extent to which it is making expected contributions to the costs of the digital conversion program. Other sources of ABC revenue are also discussed.

ABC property rationalisation

4.1 The government's decision to provide additional funding to the ABC for its digital conversion envisaged that the ABC would contribute \$36 million over five years to the costs of digital conversion from the sale of ABC properties. The ABC has an extensive property portfolio located around Australia which had a value, at June 1999, of around \$415 million, offset by borrowings of \$120 million. The borrowings cover the relatively new ABC properties at Southbank in Melbourne and Ultimo in Sydney.³⁷ The Mansfield Review noted that the ABC's larger and more valuable property holdings typically feature accommodation in central business districts and include large television studios and orchestra rehearsal halls. The Review concluded that some sites may be surplus to future ABC requirements.³⁸

4.2 The Mansfield Review estimated that progressive sale of surplus or under-utilised property could possibly yield a gross return in the vicinity of \$50 million. The Review recommended that the ABC rationalise its holdings to release funds for other priority areas, including program generation and conversion to digital technology.

4.3 The ABC proposed in its November 1997 submission to the government that its property sales occur in two tranches:

- sales of four properties, which had already been identified as surplus or under-utilised by the ABC, for \$14 million in 1997–98, with proceeds to be applied to 'digital equipment upgrades';³⁹ and

³⁷ The ABC has other borrowings in addition to the \$138 million outstanding on these properties.

³⁸ Op cit, Mansfield Review, p.37.

³⁹ The nature of these was not specified, but the ABC advised the ANAO that these 'upgrades' include new digital radio studios in Brisbane, Canberra and Perth (as a consequence of property rationalisation) that are in addition to the digital strategy put to the government in November 1997. In June 1999, the ABC advised that \$3.77 million had been spent in 1997-98 and that it estimated it would spend \$3.2 million for Basys (Newsroom management and archive system); \$3.0 million for IT services (such as Enterprise Messaging System, voice services and other management tools); and \$4.0 million for program production (including replacement of existing 'high end' television post production facilities not covered under the digital strategy and any digital enhancements required by radio and television as production techniques change over the next five years).

- a further \$36 million⁴⁰ from net sales of unidentified other properties with proceeds to be applied to the Phase 1 digital conversion strategy (see Table 5).

Tranche 1

4.4 It was estimated that property sales for Broadcast House, Kununurra, Frenchs Forest and the Hobart Carpark, would realise \$14.8 million in 1997–98. The sale of the Hobart Carpark was delayed and \$12.865 million was received for the remaining properties as at 30 June 1999.⁴¹

4.5 At the time of the audit fieldwork, the application of the balance of the property sales that had not been spent on digital projects ie. \$3.1 million⁴² was unclear. A paper prepared for the ABC Board in June 1998 on digital funding issues referred to the funds from the second property tranche to be applied to the Corporation’s digital strategy. However, it did not refer to any of the funds raised from the first tranche, or to the expenditure on digital conversion which the Department had been advised would be rolled over into the 1998–99 year.

4.6 The ABC advised the ANAO that it was Board policy that the \$14 million expected from the first tranche of property sales was to be spent on pre-Phase 1 projects that were additional to those envisaged in its submission to the government in November 1997. The submission indicated the \$14 million would be received and spent in 1997–98 and therefore not included in the five-year strategy commencing in 1998–99.

4.7 The ABC stated that \$3.77 million was spent on digital projects from the proceeds of the first tranche of property sales in 1997–98 (see paragraph 3.1). The ANAO acknowledges that, given the scale of the ABC’s digital strategy, it would have been difficult to compile a detailed list of specific equipment required. Some broad information was provided in June 1999 about where the balance of funds would be spent. The ABC advised that systems are in place or will soon be in place to track pre-Phase 1 expenditure. However, without a reconcilable list of items covered by either the pre-Phase 1 or Phase 1 projects, there remains scope for varying interpretations of what was included in the ABC’s approved

⁴⁰ Derived from the Mansfield Review’s \$50 million less the \$14 million expected from the first tranche of property sales.

⁴¹ The amounts estimated and realised for each property have been aggregated for the purposes of this public report as some property disposals were subject to confidentiality agreements.

⁴² Balance of \$6.9 million of property sales during 1997-98 less 1996-97 digital conversion expenditure of \$3.77 million.

digital strategy.⁴³ Such details would also assist both the ABC and the ANAO in tracking digital expenditure.

Tranche 2

4.8 Although the ABC Corporate Plan for 1997–2000 foreshadowed that the long-term property strategy would be completed by March 1998, the strategy was not considered by the Board until February 1999. It was sales from this strategy that were to provide \$36 million towards the ABC's contribution to the cost of the digital conversion. In the period prior to February 1999, the ABC commissioned a series of studies to ascertain the best options for the use of its properties and in some cases conducted negotiations with developers in order to put a series of proposals to the Board for consideration.

4.9 In February 1999, the Board endorsed the proposal to collocate the majority of the ABC's Sydney operations onto the Ultimo site with the balance in Lanceley Place, Gore Hill. It also approved the concepts proposed for Brisbane, Canberra and Perth, which included the subsequent property rationalisation or disposal of existing properties. At the time of the audit, specific decisions had not been made about the development and disposal strategy for that part of the Gore Hill site that will be surplus to the Corporation's requirements.

4.10 Because the tranche 2 property strategy has only recently been approved by the Board and no tranche 2 properties have been sold, the extent to which the ANAO can report on progress with the implementation of the strategy is limited at this time.

4.11 The ANAO noted that some preliminary work had been undertaken by the ABC on the sale and lease-back of major ABC properties in Sydney and one property (Selwyn Street) in Melbourne, but not for the larger sites at Southbank and Ripponlea. The ABC's preliminary assessment was that the sale and lease-back of ABC properties was not an attractive option for a number of reasons. However, the ANAO observed that the Mansfield and AACF Reports diverged on the question of sale and lease-back arrangements: the Mansfield Review concluded that the ABC could successfully conclude its business in significantly fewer and cheaper facilities than it occupied at the time of the report, without, however, implying that the ABC should vacate new purpose-built premises such as those at Ultimo and Southbank. (The Mansfield Review

⁴³ For example, the expenditure in 1997-98 appeared to cover items included in the approved digital strategy and the types of equipment purchased were no different to that purchased during 1998-99. In a number of cases the expenditure covered the same designated digital projects which were simply continued into the next financial year.

did not address the question of sale and lease-back.) The first AACF report asserted that there may be significant opportunity to realise capital in excess of \$36 million through sale or sale and lease-back arrangements.⁴⁴

4.12 The ABC advised the ANAO that its approach to sale and lease-back is to look at each case on its merits and that it had engaged consultants to examine the sale and lease-back options for the Brisbane, Canberra and Perth properties. It also advised that consideration of sale and lease-back in Melbourne will be included in the current stage of the property rationalisation plan which is seeking options for the upgrade or replacement of the Ripponlea premises.

Any significant variations?

4.13 The ANAO noted that the estimates of the net funds to be realised from ABC property sales have been revised upwards (see Table 5). Assuming these revised estimates are achieved, a windfall of this nature could reduce the residual Phase 1 debt.

Table 5

Estimated funds to be realised from ABC tranche 2 property sales (\$ million)

<i>ABC Property Realisation</i>	<i>Original Estimates</i>	<i>Revised Estimates</i>
<i>Gore Hill</i>	25	25
<i>Brisbane, Canberra, Perth</i>	11	14.25–19.2
Totals	36	39.25–44.2

Source: ANAO analyses of ABC Board Papers.

4.14 The government has made clear its expectation that any windfall gains accruing to the ABC from property rationalisation or other relevant revenue sources should be used to repay Phase 1 debt.

4.15 Although a February 1999 ABC Board paper disclosed that property sales may net up to \$44.2 million⁴⁵ (that is an additional \$8.2 million not including any windfall that might be obtained from the Gore Hill site), it indicated that only \$36 million would be available from property rationalisation to contribute to the costs of digital conversion.

4.16 In December 1997, property consultants advised the ABC that the sale of the Gore Hill site, excluding the area that is now proposed to be retained at Lanceley Place, could generate a range of sale proceeds—high, medium and low.⁴⁶ For modelling purposes the ABC used the medium level of \$25 million in its estimate of \$36 million from property sales.

⁴⁴ Op cit, Mansfield Review, pp 6, 10, 38 and AACF December 1997 Report, p. 53.

⁴⁵ Elsewhere in related Board papers shown as \$41.5 million.

⁴⁶ For commercial reasons, the ABC requested that the estimated maximum and minimum figures not be disclosed in the ANAO's public report

4.17 The ANAO was advised that ABC management remained confident of achieving the \$36 million for the second tranche of its property sales. According to the ABC, it was possible that it may get more, depending on the market at the time of sale and any costs associated with disposals, such as agent's fees and any rezoning, demolition and site remediation required.

Timing of property revenue

4.18 As indicated in Chapter 2, in its November 1997 proposal to the government and prior to identifying the specific sites for disposal, the ABC initially estimated that it would receive the proceeds of its second tranche of property sales in equal amounts of \$12 million over each of the three years from 2000–01. Following identification of the properties to be rationalised, the timing of expected receipt of the proceeds was revised. In June 1999 it was expected that \$2 million will be received in 1999–2000 and \$34 million in 2001–02. However, the increase in the NPV of the property proceeds as a result of this change in timing is only \$0.23 million.

Other sources of revenue?

4.19 In 1998–99 the ABC earned about \$12 million net revenue from ABC Enterprises (forecast at \$11.2 million for 1999–2000),⁴⁷ \$7 million from other business activities⁴⁸ and \$3 million from interest received. This is in addition to some \$10.7 million in 1998–99 it earned from program cost offsets, such as co-productions (forecast at \$8.6 million in 1999–2000) which do not generate net revenue but provide contributions to offset the costs of programs. The ANAO noted that there has been considerable growth in the contribution from ABC Enterprises from around the \$4.8 million 1996–97 budgeted figure at the time of the Mansfield Review.

4.20 It was also noted from the 1997–98 Annual Report that the ABC received \$12.1 million from sales of property (\$6.8 million) and plant and equipment (\$5.3 million) during 1997–98, compared to a total of some \$4.7 million the previous year. The ANAO did not attempt to quantify the funds potentially available from future sales of surplus plant and equipment, as this was beyond the scope of the audit.

⁴⁷ Sales from 28 ABC shops, 96 ABC Centres and a mail and telephone order service. Includes the production of books, classical and contemporary recordings, audio cassettes, videos, multimedia and licensed products, and music and magazine publishing.

⁴⁸ Such as program sales, stock footage and '24 Hours' magazine and hiring out of ABC production facilities.

4.21 The ABC advised the ANAO that the revenue identified above has already been allocated to program budgets.

4.22 Potential also exists for the ABC to earn additional revenue streams in the future using the radio frequency spectrum granted to it for digital broadcasting services. At the time of the audit these had not been quantified and the ABC stated that broadcasters were not in a position to identify these. However, it is expected that details of these will emerge as the ABC conversion to digital progresses and the relevant government policy reviews⁴⁹ are finalised.

4.23 In February 1999 there had also been discussion within the ABC about whether funds could be raised through the sale of 49 per cent of ABC Online. A figure of \$250 million was included in media reports and raised in Senate Estimates Committee but ABC Board papers do not record this figure and it has not been tested.

4.24 The ABC Board has not endorsed the sale of ABC Online, but was exploring opportunities to raise revenue from the activities of ABC Online on the basis that it continues to be vertically integrated within the ABC and remains free of advertising or sponsorship. In March 1999, the Board also approved the establishment of a new unit within ABC Enterprises to coordinate the online service's business development. The March submission to the Board made it clear that any revenue generated by ABC Online is to be returned to program making.

4.25 Efficiency savings of \$5 million to \$10 million over five years from the use of digital technology were mentioned in the November 1997 submission to the government. At the time of the audit the ABC had not specifically identified or quantified any potential operational efficiencies or cost savings from this change in technology.

4.26 Savings from outsourcing of activities or functions currently performed in-house, improved transmission technologies and other operational savings, as well as revenue potentially available from program rights, were not examined by the ANAO, as these matters were beyond the scope of the audit.

⁴⁹ These reviews are outlined in Chapter 1.

Are adequate systems in place to identify all property rationalisation proceeds related to digital conversion?

4.27 No tranche 2 property rationalisations had been finalised at the time the audit was completed. However, as stated in Chapter 3, the investment management module set up within SAP provides a good framework for future recording of the net proceeds of property sales.

Audit conclusions

4.28 There was no detailed list of equipment that underpinned either the pre-Phase 1 or Phase 1 digital projects. The ANAO acknowledges that, given the scale of the ABC's digital strategy, a detailed list of specific equipment would have been difficult to develop. The ABC advised that systems are in place or will soon be in place to track pre-Phase 1 expenditure. However, without a reconcilable list of items covered by either the pre-Phase 1 or Phase 1 projects, there remains scope for varying interpretations of what was included in the ABC's approved digital strategy. Such details would also assist both the ABC and the ANAO in tracking the ABC's digital expenditure.

4.29 The ANAO was not able to reach any conclusions about the quantum of proceeds from the second round of property rationalisations, as no tranche 2 properties had been sold at the time of the audit. This followed delays in approving the strategy for the disposal of surplus properties. The estimated timing of the realisation of funds has been revised with the bulk of the funds expected to be realised earlier than originally forecast. However, this makes little difference in NPV terms. On the other hand, the estimates of the funds to be realised have risen by up to \$8.2 million, excluding any windfall from the sale of the Gore Hill site. The ABC's financial management system provides a good framework that should allow the ready tracking of proceeds from property rationalisations to expenditure on digital conversion.

4.30 The ANAO also noted several potential sources of other revenue available to the ABC, including dividends from ABC Enterprises, the possibility of either proceeds from the sale of 49 per cent of ABC Online or an ongoing revenue stream from Online activities and efficiencies generated by the new digital technology. The ANAO recognises, however, that some of these revenue streams have been earmarked for program purposes and that it is the Board's responsibility to determine the Corporation's priorities on strategic issues of this kind.

5. ABC digital conversion financing

This chapter examines the ABC's payment and financing arrangements for the acquisition of digital conversion equipment to ascertain whether they are designed to minimise the call on budget funds.

Funds drawdowns from government only on an as required basis?

5.1 Generally, any drawdown of funds from the Budget in advance of need provides a financial benefit to the agency at a cost to taxpayers because of interest that can be earned on those funds by the agency and the costs of interest on borrowings by the Commonwealth. The ANAO was unable to locate any cash drawdown schedule that showed when the \$4 million provided by the government was expected to be required in 1998–99. The ABC advised that the digital funding was actually included on a pro-rata basis in each of the fortnightly drawdowns made during 1998–99.

5.2 The ABC advised that it intends to quarantine funds earmarked for digital conversion and use the capital and interest earned to immediately repay any debt on digital conversion, thereby reducing the total interest burden over the life of the project. Accordingly, it assumed that the \$4 million digital funding was included in the first drawdown of its appropriation in July 1998.

5.3 The ABC's total expenditure on digital was about \$5.2 million during 1998–99, so it did not use all of its own \$6 million capital contribution for the year. The ANAO therefore concluded that the ABC drew down the government funding well in advance of it being needed. As noted above, the ABC advised that these funds were quarantined and invested, with the interest earned used to reduce the outstanding debt. The ABC said its model was based on the early drawdown of funds and that the residual debt for the government would be increased if drawdowns were received on a 'just-in-time' basis.

5.4 The ANAO calculated that the early drawdown of funds during 1998–99 did not provide the ABC with a significant financial advantage. However, as a good practice principle, funding should be drawn down on the basis of needs.

5.5 The ANAO considers that the ABC should ensure that there is an adequate audit trail for the timing and quantum of its drawdowns of government funding for digital conversion. This can be achieved by separately identifying the digital component of the funding in the drawdown schedules provided to the Department of Finance and Administration, as the SBS does. The ABC has agreed to this approach.

Lease versus purchase options considered?

5.6 Leasing rather than purchase of equipment may be a cost-effective option in some business situations. Although the tax-exempt status of the ABC means that the usual taxation benefits associated with leasing would not apply, leasing does offer the prospect of reducing the call on capital expenditure and spreading payments over a number of years based on the useful life of the assets to be acquired.

5.7 The ANAO noted that there was no documentation to show that the ABC had considered the costs and benefits of leasing versus outright purchase of its digital equipment requirements. The ABC advised that it had conducted a major technology exercise on leasing of personal computers. This determined that it was more expensive for the ABC to lease rather than purchase but that leasing had some significant maintenance benefits, which overall made it marginally advantageous to the ABC.

5.8 The ABC stated that it had not given leasing significant consideration in the digital conversion exercise because it has not been in a position to evaluate the cost-effectiveness of leasing broadcast equipment. The equipment schedules and prices are subject to a detailed tender process in train at the time of the audit so there were no firm proposals against which the market could be tested. Suppliers of broadcast equipment do not offer lease options other than through third party finance. The ABC also considered that leasing is an expensive option, as indicated by proposals put by suppliers to the ABC, and it could not negotiate as satisfactory an arrangement on broadcast equipment as it had for personal computers, which have some residual value at the end of the lease.

5.9 The ABC stated that, as it has the ability to borrow at a government guaranteed rate, it was always cheaper to buy rather than to lease equipment. However, it remained open to case-by-case consideration of leasing where there is significant benefit to do so.

What is the ABC's capacity to borrow?

5.10 One option for minimising the call on Budget funds is for the ABC to borrow some or all of the funds needed for digital conversion.⁵⁰ It should be recognised, of course, that there must be a capacity to repay any borrowings drawn down.

5.11 The Loan Council limit on ABC borrowings was set at \$200.1 million in March 1996. The Minister for Finance and Administration now has responsibility for approving any proposed changes in the level of the ABC's borrowings.

5.12 The Mansfield Report noted that the ABC and its subsidiaries had \$222 million of gross borrowings at end-June 1996, offset by \$67 million in cash and liquid assets, leaving a net debt of \$155 million. Based on these figures the Report commented in December 1996 that it did not consider significant further borrowings to be a prudent option. The ABC advised the ANAO that the \$67 million was not available to retire debt.

5.13 The AACF Report commented, in March 1998, that the ABC's debt levels, which were forecast at that time to rise to \$223.6 million by 30 June 1998,⁵¹ did not appear inconsistent with other public and commercial broadcasters (noting that the BBC has no debt). On the basis of benchmarking figures available at the time, AACF concluded that the ABC's level of gearing was not materially different to commercial broadcasters in Australia. The Report did not recommend further borrowings for the ABC unless revenue was increased to pay for it.⁵² On the other hand, AACF stated that, under an alternative property rationalisation option, it may be possible for the ABC to take a short-term borrowing facility to cover a funding shortfall in earlier years, that could be repaid from an anticipated surplus in later years.

5.14 The ANAO has updated the Consultant's comparisons in Tables 6 and 7, to reflect the latest available data.

5.15 The government was advised in March 1998 that the ABC would have a debt of around \$208 million in 1998–99 and would not repay a \$33 million loan for redundancies until 2000–01, leaving a debt level of around \$175 million in 2000–01. However, as at 30 June 1999 the redundancies loan had been repaid in full and total borrowings had reduced to \$140 million (unaudited).

⁵⁰ Assuming that the ABC meets the interest costs from its ongoing appropriations.

⁵¹ Actual gross borrowings at 30 June 1998 were \$202 million.

⁵² The AACF March Report, at p.6 and p.10, commented that AACF was not provided with any information on the ABC's existing or anticipated debt facilities and AACF was therefore unable to conclude on the extent to which additional borrowings could be used to finance the digital upgrade.

Table 6**Borrowings and gearing levels of commercial broadcasters in Australia (\$ million)**

	<i>Seven</i>		<i>PBL</i>		<i>Ten</i>		<i>Prime</i>	
	<i>30-6-97</i>	<i>30-6-98</i>	<i>30-6-97</i>	<i>30-6-98</i>	<i>30-6-97</i>	<i>30-6-98</i>	<i>30-6-97</i>	<i>30-6-98</i>
Borrowings	654	949	888	1,288	146	76	142	198
Total assets	1,672	2,147	3,348	3,715	580	578	290	603
Gearing	39.1%	44.2%	26.5%	34.7%	25.1%	13.1%	49.0%	32.8%

Source: Annual Reports of Seven Network Ltd, Publishing and Broadcasting Ltd, The Ten Group Ltd and Prime Television Ltd.

Table 7**Comparison of the borrowings and gearing of the ABC, SBS and other national public broadcasters (\$ million)**

	<i>ABC</i>		<i>SBS</i>		<i>BBC</i> ⁵³		<i>CBC</i> ⁵⁴	
	<i>30-6-97</i>	<i>30-6-98</i>	<i>30-6-97</i>	<i>30-6-98</i>	<i>30-6-97</i>	<i>30-6-98</i>	<i>30-6-97</i>	<i>30-6-98</i>
Borrowings	202	202	41	39	0	0	446	446
Total assets	656	840	70	85	5,199	5,444	1,833	1,665
Gearing	30.8%	24.0%	58.6%	46.4%	0%	0%	24.3%	26.7%

Source: Annual Reports.

Note that consolidated entity figures have been used, to maintain consistency with the AACF Reports.

5.16 Overall, the debt levels of the ABC and SBS have improved. The gearing level of the ABC remains generally consistent with commercial broadcasters in Australia and with overseas national public broadcasters (noting that the BBC has no debt and that the CBC is able to derive revenue from advertising). The gearing level of the SBS is improving but was higher than comparable broadcasters in both years.

5.17 In comparing debt levels, as indicated by AACF it is important to note that:

- the ABC and SBS are non-taxable entities;
- commercial broadcasters (and the SBS) generate revenue from advertising, whereas the ABC's charter prevents it from advertising;
- commercial broadcasters service borrowings from profits, while the ABC and SBS service borrowings from appropriations from the government;⁵⁵ and
- commercial broadcasters are responsible for generating an acceptable

⁵³ Converted at the rate current at 1 July 1998 of one Australian Dollar equals 0.3716 UK Pounds

⁵⁴ Converted at the rate current at 1 July 1998 of one Australian Dollar equals 0.9084 Canadian Dollars.

⁵⁵ Although the SBS may also service borrowings from its advertising revenues, which are subject to its legislation.

rate of return for their shareholders, while the ABC's charter requires it to provide a comprehensive broadcasting service to the public. The SBS is required to provide multilingual and multicultural broadcasting services under its charter.

Table 8

ABC ratios of borrowings to liquid assets for years ended 30 June 1996, 1997 and 1998 (All figures in \$ million, except ratios)

	ABC Consolidated Entity			ABC Corporation			
	1996	1997	1998	1996	1997	1998	1999 ^(b)
Borrowings	222	202	202	204	191	191	140
Cash and liquid assets ^(a)	67	63	60	50	57	45	36
Net borrowings	155	139	142	154	134	146	104
Ratio of borrowings to liquid assets	3.3	3.2	3.4	4.1	3.4	4.2	3.9

Source: ANAO analyses of ABC Annual Reports.

Note (a) The ABC advised that the full amount of its cash and liquid assets was not available for retiring borrowings as these figures include some funded provisions where the funds have been invested until payments are due.

(b) 1998–99 Consolidated figures were not available at the time of preparation of this report. ABC Corporation 1998–99 figures were provided by the ABC and were unaudited.

5.18 Table 8 shows that, based on unaudited figures as at 30 June 1999, the ABC Corporation was some \$50 million better off in terms of its net borrowings than at the time of the Mansfield Review.

5.19 The ABC has acknowledged that it does have a greater capacity to borrow than at the time of the government digital funding decisions. However, the ABC stated that it has a policy of only borrowing to fund projects that are expected to be self-financing. This avoids the borrowing program impinging on the operational activity of the Corporation. Sinking Funds are established to quarantine any operational savings to service the debt. The ANAO was advised that this policy had been in place for a number of years and was re-approved by the Board in May 1998.

Ability to service loans

5.20 To analyse the ability of the ABC to service loans, the ANAO compared changes in the ABC's interest payments and the ratio of interest payments to both the ABC's appropriations and total revenues of the ABC. It was evident that the ABC's financial position in terms of the affordability of servicing interest on borrowings had improved since the time of the Mansfield Review (see Table 9). The ANAO was advised that the interest bill during 1998–99 was about \$13 million, comprising \$8.5 million on current borrowings plus \$4.2 million for amortised interest rate swaps. This is an annual saving of about \$2.4 million compared to the previous year or \$10.5 million compared to 1996–97.

Table 9**ABC interest payments and related data for years ended 30 June 1996, 1997 and 1998**

	YEAR ENDED 30 JUNE		
	1996	1997	1998
Interest payments	\$21.2m	\$23.2m	\$15.1m
Appropriations ^(a)	\$597m	\$588m	\$556m
Interest as a percentage of appropriations	3.54%	3.94%	2.71%
Times interest coverage	28.2	25.3	36.9
Total revenues	\$728m	\$732m	\$707m
Interest as a percentage of total revenue	2.91%	3.17%	2.13%
Times interest coverage	34.4	31.5	46.9

Source: ANAO analyses of ABC Annual Reports (Consolidated figures).

Note (a) – Including resources provided free of charge.

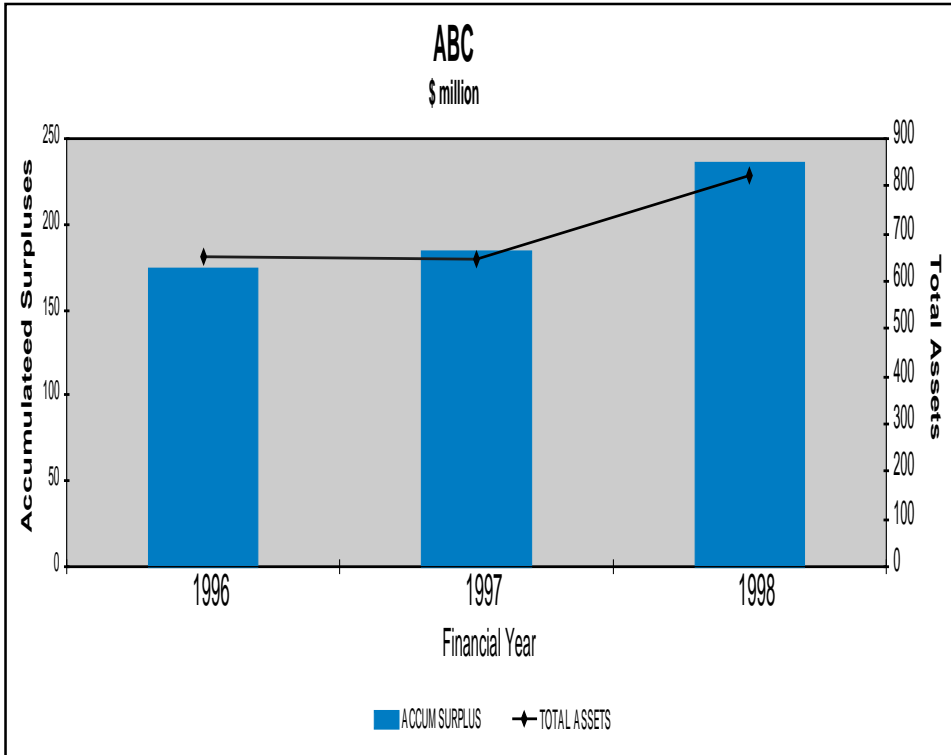
Assets and accumulated surpluses

5.21 Other indications of the financial health of an organisation can be found by examining changes in its surpluses, assets and equity. The ABC had a surplus of almost \$53 million in 1997–98. This was an increase of 544 per cent on the previous year's figure and, as shown in Figure 3, brought the total accumulated surpluses to over \$236 million. During 1997–98 assets also increased by \$176 million or 27 per cent to \$824 million. Total equity rose from almost \$294 million, or 45 per cent of total assets, at end-June 1996, to over \$500 million, or 61 per cent of total assets, at end-June 1998. Annual appropriations from the government declined by about \$10 million and the net annual cost of ABC services rose by around \$3 million during this period. The ABC's 1998–99 figures for surpluses, assets and equity were not available at the time of preparation of this report.

5.22 The ABC advised the ANAO that it recorded more than \$80 million in abnormal gross revenue items during 1996–97 and 1997–98, covering the writeback of superannuation liability and the capitalisation of assets, such as the ABC's music library and the sound and film libraries. The ABC also advised that the increase in assets during 1997–98 was due to revaluations totalling almost \$149 million, as a result of the government decision to adopt the deprival method of valuation.

Figure 3

ABC accumulated surpluses and total assets for years ended 30 June 1996, 1997 and 1998



Source: ANAO analyses of ABC Annual Reports.

Borrowing capacity fully utilised?

5.23 The ABC advised that it would seek an increase in its borrowing limit to cover its new building at Ultimo. However, there was no evidence that the ABC had considered its ability to provide a greater contribution to the costs of digital conversion by consolidating or refinancing its existing loans. On the other hand, in February 1999, in the context of considering funding options for the proposed new building on the ABC's Ultimo site, the Board was advised that some \$8 million per annum was available by restructuring the current loans for the Ultimo and Southbank buildings. Funds to repay a loan on the proposed new building at Ultimo could be generated because there had been falls in interest rates since the loans on the original Ultimo and Southbank buildings were taken out. This allowed for a reduction in the level of repayments on those buildings if the loans were extended from 14 years, at the current rate of repayments, back to the original 20 year term. The Board was first alerted to the possibility of restructuring the Ultimo and Southbank building loans in May 1998.

Audit conclusions

5.24 The ABC has drawn down the \$4 million government contribution to digital conversion in 1998–99 in advance of need. The government funding contribution has been invested and the interest is to be applied to the digital conversion debt. Although the cost to the Commonwealth is not significant, ideally, the drawdown should be timed to meet funding requirements.

5.25 The ABC advised that it was not in a position to give significant consideration to the costs and benefits of leasing digital equipment compared with purchasing such equipment. However, it advised that it remained open to case-by-case consideration of leasing where there is significant benefit to do so.

5.26 Changes have occurred in the financial situation of the ABC since the assumptions underpinning the government decisions on Phase 1 funding were made. These include increases in the levels of assets, equity and annual surpluses, which the ABC states result from a change in government accounting policy; and a \$50 million decline in net borrowings, against a background of falling interest rates and generally increased loan affordability.

5.27 The ABC has acknowledged that it does have a greater capacity to borrow than at the time of the government's decision on digital funding. However, the ABC has a policy of only borrowing for projects that are self-funding and proposes to use its borrowing capacity to fund a new building at Ultimo as part of its co-location strategy.

5.28 Although a matter for the ABC Board, the ABC has not considered providing a greater contribution to the costs of digital conversion by consolidating or refinancing its loans. The ANAO notes that if the ABC borrows to finance the new building at Ultimo, this is likely to reduce the Corporation's capacity to borrow funds for its digital conversion. However, it is the responsibility of the ABC Board to determine the ABC's expenditure priorities and borrowing capacity.

6. SBS digital conversion estimates

This chapter provides background information about the SBS and its plans for digital conversion. It also examines the estimates prepared by the SBS for the costs associated with Phase 1 of the conversion and the quality assurance processes adopted to give confidence that they reflect the minimum reasonable costs of the conversion to digital broadcasting.

The SBS

6.1 The Charter of the Special Broadcasting Service Corporation says that:

The principal function of the SBS is to provide multilingual and multicultural radio and television services that inform, educate and entertain all Australians and, in doing so, reflect Australia's multicultural society.⁵⁶

6.2 The SBS broadcast more than 6000 hours of television programming during 1997–98, with some 55 per cent in languages other than English, representing 157 cultures. It also broadcast more than 33 000 hours of radio programming in 68 languages. The SBS website was launched in February 1997 and received almost 2.3 million visits per month by mid-1998, reducing to about 1.5 million per month in mid-1999.

6.3 As a national broadcaster, the SBS is part of the Communications, Information Technology and the Arts portfolio, with responsibility for its oversight entrusted to a Board of Directors. It will receive government appropriations of about \$114 million in 1999–2000 supplemented by other income of around \$26 million, including from advertising, sponsorship, production services and the sale of programs.

6.4 At 30 June 1999, the SBS had a total of 742 staff, with 589 in Sydney, 145 in Melbourne and eight in Canberra.

SBS digital conversion

6.5 In May 1994 the then government provided the SBS with a grant of \$1 million for each of the years 1994–95 to 1996–97 for research into digital transmission requirements and the replacement of obsolete production equipment.

⁵⁶ The SBS Charter is contained in section 6 of the *Special Broadcasting Services Act 1991*.

6.6 The SBS submitted a strategy to the government in September 1997 for Phase 1 of the conversion of its television and radio production and transmission facilities from analogue to digital. The SBS provided its Phase 2 strategy and cost estimates to the government at the end of June 1999.

What were the original estimates?

6.7 The SBS estimated the cost of Phase 1 of digital conversion at some \$21.5 million over five years. The SBS sought a contribution from the government of almost \$17 million with the balance coming from the sale of an SBS-owned property and increasing levels of annual contributions from the SBS capital appropriation. Table 10 sets out details of the estimated costs and sources of funds.

Table 10

SBS capital funding plan—September 1997 (\$ million)

<i>Expenditure</i>		1997-98	1998-99	1999-00	2000-01	2001-02	TOTAL
	Planned expenditure on digital conversion	3.705	3.995	4.430	4.685	4.740	21.555
<i>Sources of Funds</i>							
	Revenue from sale of Craigieburn site	-	0.750	-	-	-	0.750
	SBS capital contributions	0.5	0.7	0.8	0.9	1.0	3.900
<i>Balance</i>	Government funding	3.205	2.545	3.630	3.785	3.740	16.905

Source: SBS Board papers.

6.8 It should be noted that the government funding actually commenced in 1998-99. Accordingly, the estimates in Table 10 have now been shifted out by one year.

How were the estimates prepared?

6.9 The SBS established a project committee with representatives from TV, Radio, IT and Resources that reported to a management committee of the heads of these areas. The estimates were centrally coordinated and compiled and were generally based on a one-for-one replacement of analogue equipment plus required spares with no enhancement component.

6.10 Price lists and estimates from potential suppliers were obtained for the required digital equipment. In preparing its digital equipment plan, the SBS sought to time the purchases to meet requirements while allowing a suitable period for acceptance testing of new equipment. It also undertook some broad comparisons between its costings for digital

conversion and those derived by the ABC and commercial networks in Australia.

6.11 Figures in the original estimates were rounded up to include contingencies (stated to be three to five per cent) but did not include adjustments for inflation or exchange rate fluctuations.

Are the estimates reasonable?

6.12 The AACF review supported the SBS digital strategy and recommended to the government that the estimates, in their words, be 'green lighted'. The government endorsed the SBS strategy for conversion to digital and accepted the estimates submitted. The ANAO noted the methodical approach adopted by the SBS in the development of its estimates. Given the level of uncertainty surrounding several aspects of the digital broadcasting environment, the estimates presented to the government by the SBS appear to be the minimum necessary for digital conversion and are considered by the ANAO to be reasonable.

Have the estimates been revised?

6.13 The SBS spent more on digital conversion during 1998–99 than it had included in the original estimates submitted to the government in September 1997. Changes to the SBS contribution from the proposed sale of its property at Craigieburn are discussed in Chapter 8.

6.14 In June 1999, the SBS Board approved revised estimates and timing for its Phase 1 digital expenditures (see Table 11). The increase in total planned Phase 1 expenditure, from \$21.555 million to \$22.552 million, reflects the indexation of prices and a small increase in equipment purchases. The total SBS Phase 1 contribution has also increased from \$4.65 million to \$4.85 million.

Table 11

SBS revised capital funding plan—June 1999 (\$ million)

<i>Expenditure</i>		<i>1998–99</i>	<i>1999–00</i>	<i>2000–01</i>	<i>2001–02</i>	<i>2002–03</i>	<i>TOTAL</i>
	Planned expenditure on digital conversion (Phase 1 only)	4.405	4.035	4.700	5.197	4.215	22.552
<i>Sources of Funds</i>							
	Revenue from lease of Craigieburn site	-	0.075	0.075	0.075	0.075	0.300
	SBS capital contributions	1.200	1.360	0.825	1.022	0.140	4.547
<i>Balance</i>	Government funding	3.205	2.600	3.800	4.100	4.00	17.705

Source: SBS papers.

Audit conclusions

6.15 The SBS adopted a robust approach to its digital conversion planning, which generally involved the one-for-one replacement of analogue with digital equipment. The SBS digital strategy was endorsed by AACF and accepted by the government. There have been some subsequent adjustments to the pattern of expenditure and some minor alterations to the estimates although these do not have a significant impact on government funding requirements.

6.16 Overall, the ANAO concluded that the SBS had adopted processes that gave confidence that the Phase 1 estimates submitted to the government in September 1997 represented the minimum necessary for this phase of its digital conversion.

7. SBS digital conversion expenditure

This chapter examines the actual expenditure to 30 June 1999 by the SBS under Phase 1 and the extent to which it conforms with the terms of the government's decision to provide funding for the conversion to digital broadcasting.

How much has the SBS spent to date on digital conversion?

7.1 Between 1 July 1997 and 30 June 1999 the SBS spent \$5.18 million on digital conversion and at end-June 1999 had committed a further \$0.26 million. The SBS spent \$0.77 million on digital conversion in 1997–98 from its capital appropriation. The SBS originally estimated it would spend some \$3.7 million on digital during 1998–99, however, actual expenditure totalled \$4.4 million (see Table 12).

Table 12

SBS digital conversion expenditure from 1 July 1998 to 30 June 1999 and commitments at 30 June 1999 (\$ million)

	<i>SPENT</i>	<i>COMMITTED</i>	<i>TOTAL</i>
Satellite	2.11	-	2.11
Television	2.10	0.26	2.36
Radio	0.20	-	0.20
Totals	4.41	0.26	4.67

Source: SBS papers.

Are adequate systems in place to identify all expenditure related to digital conversion?

7.2 The SBS set up three separate accounts (TV, Radio and Satellite) in its financial management information system that gave good control and visibility of its 1998–99 digital conversion expenditure. The ANAO noted the speed and ease with which required information could be extracted and the generally informative descriptions of the items purchased.

Is all the expenditure related to digital conversion?

7.3 The ANAO tested all purchases of \$10 000 or over that were attributed to the three SBS digital conversion accounts during 1998–99 and found that they were consistent with the ANAO's understanding of

the SBS's digital conversion plan that was approved by the government. The SBS had set up its systems to enable digital assets to be readily traced. The ANAO followed the trail from initial purchase documentation through to physically sighting a sample of the more valuable digital equipment assets acquired during 1998–99 and located in various areas of the Artarmon headquarters building.

Audit conclusions

7.4 Sample testing by the ANAO of digital purchases confirmed that the 1998–99 SBS Phase 1 expenditure of \$4.4 million was consistent with the government's funding decision. The systems introduced by the SBS to record digital expenditure and track digital assets function well.

8. SBS property and other revenue

This chapter examines the property strategy of the SBS and the extent to which it is making expected contributions to the costs of the digital conversion program. Other sources of SBS revenue are also discussed.

SBS property rationalisation

8.1 The SBS owns only two properties, its headquarters building at Artarmon in Sydney and the site of its radio transmission facilities at Craigieburn in Victoria. At 30 June 1999 these assets were valued at about \$40 million.

8.2 Under its Phase 1 plan, the SBS had identified the possible sale of its Craigieburn site in 1998–99 to enable a contribution of around \$0.75 million towards the costs of digital conversion.⁵⁷ During the year it became evident that the sale would not proceed and the SBS subsequently negotiated with the new owners of the NTN to lease out the property for \$75 000 per annum until 2004 with options until 2013. The SBS advised that it could not sell its Craigieburn property until the transmission facility that operates from the site is re-located. It added that it had over many years sought the cooperation of the National Transmission Agency to re-locate this facility so that SBS could divest itself of the property.

8.3 The ANAO did not sight any documentation showing that there had been active consideration during the formulation of the SBS digital strategy of the sale and lease back of the Artarmon building.⁵⁸

8.4 The SBS advised that an external consultancy review in 1993 concluded that it was not viable for the SBS to break the ten-year fixed interest loan for its Artarmon headquarters and that, although not documented, this was taken into consideration by the SBS when formulating its digital strategy. Because of the high costs to break the loan agreement, the SBS concluded that the sale and lease-back of the Artarmon property was not viable.

⁵⁷ See Table 11 in Chapter 6.

⁵⁸ The December 1997 AACF Report stated that there may be opportunities to undertake sale and lease-back arrangements to release capital value and that the financial merit of a sale relative to property ownership could be explored (see AACF Report, p. 32).

Other available sources of revenue?

8.5 In August 1997, the SBS Board considered a number of off-budget options to finance the expected costs of digital conversion. An updated capital plan⁵⁹ identified that revenue from rental of the surplus warehouse space in the Artarmon building would contribute \$0.3 million in 1998–99 and \$0.516 million in subsequent years towards digital costs (totalling about \$2 million over the first five years). It also identified that other minor revenue sources such as income from the use of the SBS transmission signal⁶⁰ could be directed towards the project, although these were not quantified in the plan.

8.6 The Board endorsed the presentation of the digital conversion strategy to the Minister but directed that the income from the above revenue streams not be included as SBS options at the time. This increased the projected funding shortfall from \$14.945 million to \$16.905 million.

8.7 The SBS advised that its rental income is already committed. Only some \$260 000 of the rental income was available for use by the SBS in 1998–99 after the costs of bringing the space up to a lettable standard. In future, some \$0.5 million will be available for essential building maintenance, with the remaining funds to be used for programming needs.

8.8 The ANAO observed that the SBS established a ‘Revenue Reserve Fund’ in June 1998, to act as a buffer for those occasions when revenues fall short of budget estimates. The SBS stated that the Fund is to receive the interest earned on the SBS Independent⁶¹ cash holdings, any revenue received over budgeted levels and the proceeds of sales of superseded betacam equipment. The intention is to build the Fund up to about ten per cent of the SBS revenue budget. No transfers into the Fund had been made as at 30 June 1999.

8.9 The ANAO noted that other income received by the SBS had increased from around \$18.6 million in 1996–97 to almost \$29 million in 1998–99. A major contributor to this was the significant increase in gross annual advertising revenue, which rose from \$11.87 million in 1996–97 to \$21.243 million in 1997–98, and was \$19.47 million in 1998–99. The SBS

⁵⁹ The Board had considered earlier plans in December 1995 and January 1997.

⁶⁰ Such as use of the Vertical Blanking Interval (akin to the blank spaces between picture frames on a roll of film) for data transmission. SBS has one contract in place that provides revenue of \$10 000 per annum plus a small percentage of the data provider's sales revenue.

⁶¹ SBS Independent was established in 1994 as the network's commissioning arm for television programming from Australian independent producers.

commented that its increased advertising revenue was largely due to the World Cup and the revenue generated by the World Cup was more than offset by the additional expenditure required to cover this event. It stated that there has been little or no increase in net resources available to the SBS from advertising revenue. These comments have not been confirmed by the ANAO.

8.10 The ANAO also noted that the SBS had not quantified any operational efficiencies, revenue or cost savings potentially available to the SBS arising from the use of digital technology. However, these benefits may become clearer as the conversion to digital progresses and government policy reviews affecting the implementation of digital technologies for broadcasters⁶² are finalised.

Audit conclusions

8.11 Although the SBS had intended to sell its Craigieburn property it became evident that the sale would not proceed and the property has been leased out. This moderately affects the quantum and timing of the funds available to be applied to the costs of digital conversion. However, it is not material.

8.12 There are other possible sources of additional revenue available to the SBS, such as its advertising revenue and rental income from surplus warehouse space in the Artarmon building. The ANAO recognises, however, that responsibility for determining priorities on the allocation of SBS revenue rests with the SBS Board.

⁶² These reviews are outlined in Chapter 1.

9. SBS digital conversion financing

This chapter examines the SBS's payment and financing arrangements in place for the acquisition of digital conversion equipment to ascertain whether they are designed to minimise the call on budget funds.

Funds drawdowns from government only on an as required basis?

9.1 The SBS drew down its 1998–99 digital conversion funding from the government of \$3.2 million in three equal instalments between 1 July and 6 November 1998. These drawdowns were well in advance of SBS needs, given that the SBS had significant cash on hand at the time and the drawdowns were considerably ahead of the actual digital expenditure.⁶³ Ideally, the drawdown of government appropriations should be timed to meet actual SBS funding needs.

9.2 The SBS stated it prepares its drawdown schedules at the start of each financial year and does not revise them unless there is an unexpected cash shortfall.

Lease versus purchase options considered?

9.3 The ANAO found that the SBS had considered leasing rather than purchasing digital equipment. For example, the SBS had initially purchased digital equipment worth \$435 000 but in June 1998, sold and leased back some \$310 000 of this over a five-year period. The SBS also commenced leasing its computer equipment requirements in March 1998.

9.4 The ANAO also found that in August 1997 the SBS Board considered a digital conversion capital funding plan that included an option of leasing the required equipment for five years and spreading the payments over a nine-year period. The SBS calculated that this option was less favorable than funding the identified shortfall between the cost of digital conversion and the SBS's contribution. The Board decided not to include the leasing option in its proposal to the Minister.

9.5 There was no evidence of further consideration by the SBS in 1998–99 of the costs and benefits of leasing versus purchasing its digital equipment requirements. The ANAO was advised that the SBS engineers

⁶³ SBS had spent about \$1 million when it drew down the final instalment.

preferred to own rather than lease equipment. However, the ANAO noted that there had been no quantification of the costs and benefits of the alternative options. The SBS advised the ANAO that it considers the large scale leasing of on-line broadcasting equipment is not viable. It stated that there are several reasons for this, including the need for the SBS to reduce risk and be in total control of its core on-air assets. It considers that ownership is vital to achieve the SBS's requirement for flexible use of equipment. The SBS added that the maintenance of technical broadcasting equipment is a highly specialised field and many modifications are made to the equipment, which is not possible when a third party owns the assets.

What is the SBS's capacity to borrow?

9.6 The SBS advised that its Loan Council limit on borrowings was set at \$39 million in 1991 and has not required revision since then. The Minister for Finance and Administration now has responsibility for approving any proposed changes in the level of SBS borrowings.

9.7 Compared with the ABC, the SBS can maintain a relatively higher debt ratio because, unlike the ABC, it has the ability to raise advertising revenue that can be used to repay borrowings. AACF reported there was no significant opportunity for the SBS to raise additional debt unless increased revenue could be generated to cover it.⁶⁴ As stated in Chapter 8, the ANAO observed that SBS advertising and other revenue has increased significantly since the AACF reviews.

9.8 The total borrowings of the SBS at 30 June 1999 were \$33.2 million.⁶⁵ There is one interest-only loan of \$39 million over ten years for the Artarmon building that is offset by a \$8.5 million sinking fund plus additional borrowings of \$2.7 million from future parliamentary appropriations being repaid at \$0.9 million per annum. The SBS also had leases of \$1.2 million at 30 June 1999.

9.9 AACF analysed the SBS's debt position in early 1998 and compared it with those of other broadcasters. The ANAO has updated the AACF comparisons in Tables 6 and 7 to reflect the latest available data. As noted earlier in Chapter 5, the gearing level of the SBS has improved.

⁶⁴ These AACF comments were included in the Cabinet submission of March 1998 but the SBS debt levels were not specifically mentioned. However, they were included in the AACF Reports that were made available to Cabinet.

⁶⁵ Excluding leases.

Table 13

SBS ratios of borrowings to liquid assets for years ended 30 June 1996, 1997 and 1998 (All figures in \$ million, except ratios)

	SBS Consolidated Entity			SBS Corporation			
	1996	1997	1998	1996	1997	1998	1999 ^(c)
Borrowings ^(a)	35.4	41	38.6	35.4	41	38.6	34.4
Cash and liquid assets ^(b)	0.6	4.5	6.1	0.6	4.5	5.7	11.7
Net borrowings	34.8	36.5	32.5	34.8	36.5	32.9	22.7
Ratio of borrowings to liquid assets	59.0	9.1	6.3	59.0	9.1	6.8	2.9

Source: ANAO analyses of figures in SBS Annual Reports and as provided by the SBS.

Note (a) After offsetting the balance of the SBS loan sinking fund. Also includes leases.

(b) Excludes cash in the SBS loan sinking fund and shares costing \$3.67 million held by Multilingual Subscriber Television Ltd (MSTL) in Pan TV, which the SBS advised are held as an investment. For consistency with ABC tables elsewhere in this report, Table 13 excludes all SBS receivables. If receivables are included as liquid assets, the ANAO considers that SBS Corporation net borrowings have fallen by \$14 million, from \$29 million to \$15 million, over the period June 1996 to June 1999. The SBS considers that these figures should exclude the MSTL/Pan TV receivables (recorded at \$1.77 million in 1995–96, \$2.72 million in 1996–97 and \$3.67 million from 1997–98, indicating that net borrowings have fallen by \$12 million, from \$30 million to \$18 million.

(c) 1998–99 Consolidated figures were not available at the time of preparation of this report. SBS Corporation 1998–99 figures were provided by the SBS and were unaudited.

9.10 Unaudited figures in Table 13 indicate that the SBS Corporation's net borrowings position appears to have improved by about \$12 million over the three years to end-June 1999.⁶⁶ Cash holdings at end-March 1999 were almost \$25 million and at 30 June 1999 were \$11.7 million, some \$5.7 million above budget. The SBS advised the ANAO that its significant cash reserves are only temporary in nature and a large proportion is for non-discretionary expenditure that will occur in the near future.

Ability to service loans

9.11 The ANAO considers that in the current environment of low interest rates, loan affordability for the SBS should have improved since the time of the government's Phase 1 digital funding considerations. Table 14 shows that the position in relation to interest payments for the SBS, as measured by various indicators, has been reasonably stable over the period June 1996 to June 1998. To a large extent, this reflects the fact that the SBS has a ten-year fixed interest loan, which matures in 2002. The costs to break this loan agreement are considered by the SBS to be prohibitive.

⁶⁶ This excludes the \$8.5 million in the SBS loan sinking fund.

Table 14**SBS interest payments and related data for years ended 30 June 1996, 1997 and 1998**

	<i>YEAR ENDED 30 JUNE</i>		
	<i>1996</i>	<i>1997</i>	<i>1998</i>
Interest payments	\$4.30m	\$4.26m	\$4.65m
Appropriations ^(a)	\$92m	\$91m	\$92m
Interest as a percentage of appropriations	4.67%	4.67%	5.0%
Times interest coverage	21.4	21.4	19.8
Total revenues	\$112m	\$110m	\$122m
Interest as a percentage of total revenue	3.82%	3.88%	3.83%
Times interest coverage	26.2	25.8	26.1

Source: ANAO analyses of consolidated figures in SBS Annual Reports.

Note (a) – Including resources provided free of charge.

Assets and accumulated surpluses

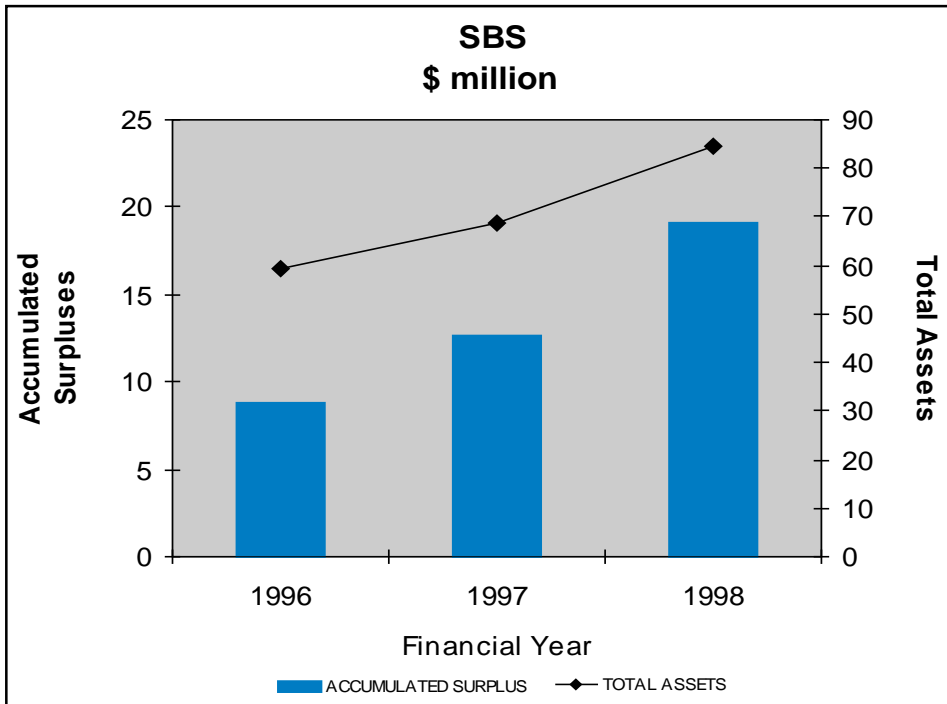
9.12 The SBS had a surplus of almost \$6.5 million in 1997–98. This was an increase of 67 per cent on the previous year surplus of \$3.9 million and 622 per cent on 1995–96 surplus of \$0.9 million. As shown in Figure 4, the total accumulated surpluses increased from \$8.8 million in 1996 to \$19.1 million in 1998.

9.13 Over the two years to 30 June 1998 assets increased by almost \$25 million or 42 per cent to \$85 million. Total equity increased by \$20.3 million or 328 per cent, from around \$8.9 million to \$29.2 million over the period. The figures for SBS 1998–99 surpluses, assets and equity were not available at the time of preparation of this report.

9.14 The SBS commented that approximately \$10 million of the increase in its assets and equity results from revaluations of its land, building, plant and equipment, while more than 60 per cent of the increase in the surplus for 1997–98 results from funding received for the special production fund for SBS Independent. The SBS acknowledged that its financial position is improving, but considers that improvements were required from the previous levels of liquidity. The SBS stated it did not have the capacity to utilise its surpluses towards the costs of digital conversion.

Figure 4

SBS accumulated surpluses and total assets for years ended 30 June 1996, 1997 and 1998



Source: ANAO analyses of figures in SBS Annual Reports.

Borrowing capacity fully utilised?

9.15 There was no documentation showing that the SBS considered the refinancing of its existing loan when preparing its digital submission to the government in late 1997. At that time the SBS had only one loan, which was for its Artarmon building and had a balance of \$35.4 million.

9.16 The SBS engaged consultants to review its Artarmon loan facility in February 1993 and again in February 1998. Both reviews concluded that it would not be worthwhile to break the current loan agreement.⁶⁷ The SBS advised that it was mindful of the conclusions of the 1993 consultant’s report when it was preparing the 1997 digital strategy.

9.17 The SBS currently has unused borrowing capacity as it has reduced its borrowings since the assumptions underpinning the government funding decision were made. However, the SBS considers that its current debt level is too high and that the current operating environment does not enable it to take on further debt to fund digital purchases.

⁶⁷ The break cost on the \$39 million loan was \$7.3 million.

9.18 The SBS advised that it will be able to contribute some additional resources to Phase 2 of digital conversion in the longer term, from 2003 when its current Artarmon building loan matures and from 2004 when its Phase 1 contributions cease.

Audit conclusions

9.19 The SBS drew down the government's 1998–99 contribution to digital conversion well in advance of need given that the SBS had significant cash reserves at the time and the drawdowns were considerably ahead of the actual expenditure.

9.20 The SBS had considered the costs and benefits of leasing versus purchasing of digital equipment when it was developing its digital conversion capital funding plan but found leasing was a less favorable option.

9.21 Improvements have occurred in the financial environment in which the SBS has operated since the assumptions underpinning the government decision on Phase 1 funding were made. These include a significant rise in the cash held by the SBS; increases in the levels of assets, equity and annual surpluses; together with a decrease of around \$12 million in net borrowings, against a background of falling interest rates and generally increased loan affordability. Taken together with the increases in income discussed in Chapter 8, these suggest an improved capacity for the SBS to contribute to the costs of digital conversion. The SBS disagrees with this assessment. The SBS acknowledged that its financial position is improving, but considers that improvements were required from the previous levels of liquidity.

9.22 The ANAO recognises that it is the responsibility of the SBS Board to determine the SBS's expenditure priorities and borrowing capacity.



Canberra ACT
21 September 1999

P. J. Barrett
Auditor-General

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