

VICTORIA

Auditor-General
of Victoria

**REPORT ON
MINISTERIAL
PORTFOLIOS
MAY 1997**

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May 1997

The President
The Speaker

Parliament House
Melbourne, Vic. 3002

Sir

Under the authority of section 15 of the *Audit Act* 1994, I transmit my Report on Ministerial Portfolios. The Report also contains a section on the Parliament of Victoria as well as a section on matters of broad scope interest.

This Report completes the cycle of my auditing activities in relation to the 1995-96 financial year.

Yours faithfully

C.A. BARAGWANATH
Auditor-General

Contents

Foreword	ix
PART 1 EXECUTIVE SUMMARY	1
1.1 Major findings	3
PART 2 PARLIAMENT OF VICTORIA	11
2.1 Parliament of Victoria	13
PART 3 AUDIT OF MINISTERIAL PORTFOLIOS	17
3.1 Education	19
<i>Financial management in schools</i>	21
<i>Property management at the Royal Melbourne Institute of Technology</i>	32
<i>Management of grants in relation to adult, community and further education</i>	45
<i>Losses, thefts and irregularities</i>	50
3.2 Human Services	59
<i>Private practice arrangements - follow-up</i>	62
<i>Delays in finalising Health Service Agreements</i>	65
<i>Losses, thefts and irregularities</i>	72



3.3	Infrastructure	83
	<i>Financial reporting in local government</i>	86
	<i>Transfer of municipal electricity undertakings</i>	93
	<i>Contaminated land sites</i>	97
	<i>Divestment of retail development at Geelong</i>	99
	<i>Public transport revenue protection, patronage levels and automated ticketing system</i>	104
	<i>Contracting-out of the Melbourne to Warrnambool rail passenger service</i>	113
	<i>Losses, thefts and irregularities</i>	122
	<i>Urban Land Authority - Purchase of painting from project development fee</i>	123
3.4	Justice	133
	<i>Country Fire Authority - Implementation of finance system</i>	136
	<i>Losses, thefts and irregularities</i>	147
3.5	Natural Resources and the Environment	151
	Conservation and land management	
	<i>Asset holdings and recognition</i>	154
	<i>Management of Crown land reserves</i>	157
	<i>Reform of alpine resorts</i>	163
	<i>Unaccounted water</i>	167
	<i>Losses, thefts and irregularities</i>	181
3.6	Premier and Cabinet	191
3.7	State Development	197
3.8	Treasury and Finance	203
	Department of Treasury and Finance	
	<i>Local Authorities Superannuation Board</i>	209
	<i>Financial standing of WorkCover - update</i>	213
	<i>Victorian electricity industry privatisation</i>	222
	<i>Petroleum Resources Rent Tax dispute settlement</i>	239
	<i>Reform of Victorian ports</i>	254
	<i>State Revenue Office - Revenue collection</i>	258
	<i>Thefts, losses and irregularities</i>	261

PART 4 BROAD SCOPE ISSUES		271
4.1	Corporate Governance in the Public Sector	273
4.2	Public Sector financial reporting	279
4.3	State Government Corporate Card	285
4.4	The Year 2000 issue - the Millennium Bug	299
4.5	Information Technology Security	303
PART 5 REVIEW OF THE AUDIT ACT 1994		311
5.1	Submission by the Auditor-General of Victoria	313
5.2	Response to Discussion Paper by the Auditor-General of Victoria	449
INDEX		473

Foreword

My Report on Ministerial Portfolios contains a diverse range of public interest issues which have arisen from annual financial audits of the numerous public sector agencies I am currently required to audit. The major audit findings are summarised in Part 1.1 of the Report.

REVIEW OF THE AUDIT ACT

In November 1996, the Government announced a review of the *Audit Act* 1994 under the National Competition Policy. At the time, I found it of paramount importance to write to individual Members of Parliament conveying my concerns in relation to the review which I regarded as the greatest threat to the independence, and even the very existence, of my role and to the Parliament's and community's right to know. With the recent release by the Government of the review team's report, it is highly appropriate that I now provide Parliament with my overall assessment of the report to assist its deliberations on any future proposals to amend the Audit Act.

From my reading of the review team's report, I see nothing therein which leads me to resile from the views I expressed in my letter to individual parliamentarians. However, unlike the thrust of the review team's recommendations, I firmly believe that contestability principles can be responsibly and simply applied within the current legislative framework and in a manner which is acceptable to the Parliament.

As I was denied an opportunity by the review team to see and comment on any drafts of its report, I am heartened by the fact that the Premier has announced that the Government is still considering the team's recommendations in detail and that consultation will take place.

Proposed elimination of Report on Ministerial Portfolios

At the outset, I should emphasise that this *Report on Ministerial Portfolios*, which is produced and tabled in the Parliament under section 15 of the Audit Act, may well be the last such Report presented to the Parliament. In the review team's report, it is stated that "*It is unclear to the [review team] whether section 15 will be necessary under the proposed arrangements ...*". The team evidently has assigned little, if any, value to Parliament's right to know and the unique public reporting feature of an Auditor-General's financial audit function for which there is no equivalent in the private sector.

I am staggered at the above comment by the review team and will be interested in the reaction of the Parliament and the community to the team's proposed elimination of reports on financial audit issues by the Auditor-General in the *Report on Ministerial Portfolios*. During my term as Auditor-General, this Report has been externally assessed to be a highly effective accountability medium over the Government's operations, serving the interests of the Parliament and the community.

Existing audit model has served Victoria well



Firstly, on a positive note, I am not surprised that one of the conclusions of the review team is that the current audit model has served Victoria well overall as 2 major independent evaluations of my Office commissioned by the Parliament over the last 5 years have formed highly favourable conclusions. In addition, the current Government's Victorian Commission of Audit considered, as part of its deliberations, a number of alternative arrangements for external auditing in the Victorian public sector, including the greater use of the private sector. The Commission also concluded in its May 1993 report that the current system was working effectively and change was not warranted.

Rejection of legislative objective

Despite acknowledging that the current audit model has served Victoria well, the review team has proceeded to recommend a model which represents no more than an ideological experiment in terms of the structure for future public sector auditing in Victoria.

The team's preferred model revolves around its own view of what the objective of the Audit Act should be and which is automatically presumed in its report to be beyond question.

In my March 1997 response to the team's discussion paper (refer Part 5.2 of this Report), I indicated that the team had quickly dismissed the long-standing parliamentary view of the objective or purpose of the Audit Act.

I informed the team that in my view the objective is clearly set out in the legislation which establishes the Auditor-General as the exclusive independent external auditor of government and its agencies on behalf of the Parliament and community. I also indicated to the team that the exclusivity of the Auditor-General as Parliament's and the community's external auditor was the sole legislative restriction on competition, has a negligible effect on the economy in general and has generated significant public benefits which far outweighed related costs.

In rejecting the objective already enshrined in the legislation and proposing a new audit model based on its own objective, the review team has clearly devalued, without substantiation, the distinctive strengths to the Parliament and community of the current arrangements under which the Auditor-General operates exclusively as a single audit and reporting voice.

Competition: An article of faith but with uncertain outcomes

The review team has argued at great length that competition is synonymous with improved outcomes. However, in sharp contrast to the indisputable level of benefits to the public which have been delivered under the current model, the team's report contains a number of references which convey substantial uncertainty as to the likelihood of any benefits flowing from its preferred model. The following extracts from the report (with my emphases) illustrate this uncertainty:

- "... there ***appears*** to be scope for an improved range of services and improvements in audit quality through an increased use of competition."
- "... the alternative arrangements proposed seek to capture the benefits which the [review team] considers ***may*** be generated through the greater use of competition."
- [The review team's model] "... is ***likely to lead*** to better outcomes."
- "... there is an ***expectation*** that increased use of competition will result in improvements in the audit skills available and in the quality of the audit."
- "... current arrangements ... ***may not*** create sufficient incentive to consider the possibilities of increasing competition and capturing associated efficiency gains."
- "This [the review team's model] ***should*** result in improved focus for the Auditor-General's Office and for Audit Victoria."
- "Whilst the cost of audit ***may*** rise, it is the [review team's] ***judgement*** that benefits to Victoria will exceed any rise in cost and that the reforms proposed are in the public interest."

In short, the review team has proposed a future direction for public sector auditing in Victoria which is experimental in nature and founded, as illustrated above, on speculative and conjectural outcomes.

Independence: Reaffirmation or rejection?

In my January 1997 submission to the review team and my March 1997 response to the team's discussion paper (both documents are presented in full in Part 5 of this Report), I stressed the absolute importance of the Auditor-General having total discretion on all audit matters and that operational discretion is an integral part of, and cannot be separated from, an Auditor-General's independence.

Authoritative guidance issued by both the Institute of Chartered Accountants and the Australian Society of Certified Practising Accountants support this view by maintaining that "**fundamental to the independence of the auditor is freedom to plan and conduct the audit, report findings and express an opinion free from external influence**" (Paragraph 18 of AUP32, *Audit Independence*).



In its report, the review team gives consideration to the essential elements of the operational independence of the Auditor-General which, in its view, must be preserved in any alternative model seeking to increase competition in the provision of external audit services. In this regard, it refers to the characteristics of operational independence currently contained in the Audit Act which include:

“... the right of the Auditor-General to conduct any audit he or she considers necessary to determine whether an authority is achieving its objectives, and powers to require the attendance of persons and provision of documents”.

The review team then *“... reaffirms that these characteristics must be maintained if the Auditor-General’s independence is to be retained, and effective”.* (Emphases added).

While I was initially heartened when I read the above comments, I became extremely disappointed at several elements of the review team’s preferred model articulated in its report which directly contradicted this clear reaffirmation of the characteristics of operational independence. In this regard, the review team has unequivocally rejected my right to conduct audits and has:

- dismissed contemporary Australasian parliamentary thinking on an Auditor-General’s independence;
- presented an assertion, which I do not agree with, that its recommendations will lead to a strengthening of independence of the Auditor-General;
- proposed strict boundaries which would severely restrict the Auditor-General’s exercise of discretion, remove the Auditor-General’s power to actually conduct audits and transfer control over audit field staff from the Auditor-General to the Government which is the subject of audit; and
- advocated a weakening of accountability over the performance of government activities by removal of performance audits.

Parliament’s views questioned

The importance of the principle of an Auditor-General’s total discretion on all audit matters has been reinforced by the Australian Government within draft audit legislation (post-Hilmer) currently before the Parliament. This legislation proposes to enshrine in statute complete discretion as a key element of an Auditor-General’s independence in the following terms:

“Subject to this Act and to other laws of the Commonwealth, the Auditor-General has complete discretion in the performance or exercise of his or her functions or powers. In particular, the Auditor-General is not subject to direction from anyone in relation to:

- (a) whether or not a particular audit is to be conducted; or*
- (b) the way in which a particular audit is to be conducted; or*
- (c) the priority to be given to any particular matter”.*

The above legislative direction was unanimously confirmed at the February 1997 meeting of Australasian Public Accounts Committees which included all Australian States and Territories.

.....

This contemporary parliamentary view on the independence of Auditors-General was dismissed by the review team which considered that Auditors-General should not be able to engage in anti-competitive conduct when all Australian Governments have committed themselves to the National Competition Policy and, where appropriate, to legislation in favour of competitive outcomes. The team has, in effect, assigned greater weighting to this one single government policy than a resolution passed by representatives of all Australasian Parliaments which are the primary beneficiaries of the external audit process.

In contrast to the review team's total focus on competition, the Government has recently accepted certain anti-competitive gas supply contractual arrangements presumably from a public interest perspective which could remain in place up to the year 2009 (refer to Part 3.8 of this Report).

Independence: Trappings without power, form without substance

In its report, the review team asserts that the independence of the Auditor-General would be strengthened under its preferred model by the following 3 measures:

- making the Auditor-General an independent officer of the Parliament;
- providing for the appointment of the Auditor-General by the Governor-in-Council with agreement of the Public Accounts and Estimates Committee (PAEC); and
- funding the Auditor-General's Office from the annual appropriation to the Parliament.

The value of the designation of an Auditor-General as an "independent officer of the Parliament" will, as the team's report acknowledges, be primarily symbolic especially as the team has recommended the Auditor-General will not have total discretion on all audit matters. In contrast, the Australian Government has recognised the importance of complementing its intended designation of the Australian Auditor-General as an independent officer of the Parliament by inclusion within its draft legislation of complete operational discretion to the Auditor-General. In other words, unlike the approach proposed by the review team, the Australian Government intends to match symbolism with substance.

In relation to the second measure, the involvement of the Parliament in the appointment of the Auditor-General was recommended by the PAEC in 1993 following the Fergus Ryan performance audit of my Office but was subsequently rejected by the Government.

Similarly, total funding of the Auditor-General's Office by the Parliament has previously been recommended by the PAEC and dismissed by the Government.

On the question of funding, while the salaries of my staff are, for administrative purposes only, financed via the Department of Premier and Cabinet's budget, the important issue is not the source of funding but that the staff are answerable solely to the Auditor-General who is independent of the Government.



I strongly question, therefore, the review team’s assertion that independence of the Auditor-General would be enhanced under its preferred model. In fact, nothing could be further from the truth when consideration is given to the following matters which will place significant operational restrictions on the Auditor-General:

- **The capacity of the Auditor-General to exercise discretion would be limited to rare cases and those of extreme public interest.** The use of these terms conveys an advance expectation that the future exercise of discretion by an Auditor-General will be confined only to exceptional circumstances. Apart from a significant weakening of audit independence, such a restriction, which I find extremely offensive, questions the integrity of the Auditor-General to apply discretion in a responsible manner.
- **The Auditor-General would be formally separated from audit operational staff, who will be transferred to a Government Business Enterprise (Audit Victoria) with staff answerable to the Government rather than the Auditor-General through a government-appointed board of management.** This action will disintegrate the existing experience and knowledge capital of my Office. In addition, the Auditor-General’s office would have no future direct involvement in the conduct of audits, which would leave the Auditor-General without an ongoing audit investigatory arm to serve without fear or favour the interests of the Parliament and the community. With no power to conduct audits, the Auditor-General’s role under the review team’s preferred model would be reduced to that of a regulator or contractor-general.
- **The Auditor-General would no longer have direct responsibility for the issue of audit reports and for the expression of audit opinions on financial statements as such documents would be signed by the service provider.** In fact, the responsibility of the Auditor-General would be limited to a countersigning role in terms of compliance with guidelines. Out of 51 submissions to the review team, only one submission was cited in the report as supporting removal of the Auditor-General as the sole signatory to audit opinions.
- **It is envisaged by the review team that the Government would have responsibility for assessing Audit Victoria’s future performance and even the need for its continuing existence.** This suggestion and the creation of Audit Victoria as a Government Business Enterprise raises 2 fundamental questions, namely:
 - Why should the Government as the party subject to Parliament’s external audit process have overview control over the agency conducting the audit?
 - If Audit Victoria is to be subject to government control how could audits it undertakes ever be viewed as independent of government?

If Parliament agreed that a service agency such as Audit Victoria needs to exist, ultimate control must rest with the Auditor-General (as is the case in New Zealand where the Auditor-General also has total discretion).

All of the above points raise questions as to the review team’s motive for proposing strict boundaries to the Auditor-General’s decision-making powers and ambit of activity, while at the same time purporting to enhance the independence of the Auditor-General.

Removal of performance audits

In a move which I consider to be clearly outside the terms of reference set by the Government and which has no relevance to competition principles, the review team has cited “... *the subjective nature of [performance] audits*” as its sole justification for recommending that, in future, performance audits not be undertaken and that performance reviews replace such audits.

The review team fails to acknowledge that performance audits are conducted in accordance with internationally recognised methodologies which accord with professional audit standards specifically applicable to such audits. It is therefore ludicrous for the team to recommend a far reaching change in the fundamental nature of such a key function of the Auditor-General solely on the basis of alleged subjectivity.

There are several major differences between an audit and a review, e.g. all findings from an audit must be totally supported by evidence, whereas reviews can rely merely on hearsay and reach unsubstantiated conclusions (the review team’s report is a clear example of a review). If the team’s recommendation on this point was ultimately embodied in legislation, there would be a significant downgrading of the value of reports of the Auditor-General presented to the Parliament as findings would not need to be supported by unassailable evidence.

Accountability by the accountable - subjectivity or objectivity?

The review team has also raised doubts in its report on the continued usefulness of performance audits notwithstanding the widespread recognition of the significant role currently fulfilled by such audits in reinforcing the Government’s accountability to the Parliament. The team has again opted to go beyond its charter and criticise performance audits principally from the narrow perspective of discussions it held with certain anonymous representatives of government agencies.

The review team even goes on to suggest that government agencies should have sole responsibility for evaluating the effectiveness of programs. In other words, the review team feels that Parliament and the community should not be provided with any independent objective assessments by the Auditor-General of the effectiveness of government performance.

Unsubstantiated assertions versus empirical evidence

The review team makes many references in its report to a lack of transparency in the current audit arrangements. It has conveniently overlooked the fact that all operations of my Office are subject to rigorous audits every 3 years in a performance audit commissioned by the Parliament and the findings in my Reports to Parliament have to be defended at public hearings held by Parliamentary Committees. There are no equivalent processes applying to auditors in the private sector.

In addition, the team has used anecdotal evidence and totally unsubstantiated assertions to support comments which effectively discredit and denigrate the quality of audits undertaken by my Office. The team has ignored the comprehensive information I provided to it in order to illustrate the extensive public benefits which have been derived from both financial and performance audits over many years.



I would much prefer to rely on the judgement of the Parliament and community on these matters. Eminently qualified persons from within Australia and overseas, engaged by the Parliament to assess my Office's performance, have independently concluded that the Office compares favourably with the "Big 6" chartered accounting firms in respect of financial audits, it is at the leading edge in the presentation of performance audit reports and its performance audit methodology is advanced in development by world standards.

Victoria is currently recognised nationally and internationally for its advanced public sector accountability arrangements, with the effectiveness of the State's public sector audit function a key factor contributing to this reputation. Within this framework, significant benefits in the form of the quality and consistency of auditing and breadth and fairness of external reporting in the public interest by my Office have been produced for the Parliament and the community. In contrast, the review team's experimental model has no precedent in any Westminster-based administration. The team's model has been postulated in a report which is devoid of empirical evidence and is characterised by unsubstantiated assertions, textual inconsistencies, uncertainty as to likely outcomes and recommendations based on minority views.

Responsibility for final outcome rests with the Parliament

To this point, the review process has been controlled by the Government and it is my view that from now on, the Parliament, on behalf of the community, should totally control the process and determine, through a mechanism it establishes, the manner in which contestability principles should apply to the Auditor-General.

It has been argued that I am opposed to change and, in fact, will not agree to any changes which will affect the status quo. As I have indicated from the outset of the Government's review of the Audit Act, my Office has been at the forefront of leading edge change in public sector auditing for many years. By way of example, the Office's strategy under which significant use is made of private sector resources engaged under competitive tendering arrangements was introduced in the early 1980s, many years ahead of the emergence of outsourcing as a recognised management tool in Victoria. In fact, change has been a constant in my Office over the last decade.

My single objection throughout this process has always been that a Government-appointed team, rather than a parliamentary committee, was charged with responsibility for the review. I have previously advised individual Members that I welcome independent evaluations of my Office if commissioned by the Parliament. There is no doubt in my mind that contestability principles can be responsibly and simply applied within the current legislative framework and in a manner which is acceptable to the Parliament. In fact, the significant changes recommended by the review team have very little to do with the elimination of anti-competitive provisions from existing audit legislation.

.....

Before sanctioning any legislative change, I consider it is imperative that individual Members of Parliament address 3 vital questions, namely:

- Will the Auditor-General be able to continue to serve, without fear or favour, the interests of the Parliament and the community with severely restricted discretion and without an ongoing audit investigatory arm?
- Will the level and quality of information available to the Parliament from the Auditor-General on the activities of the Government be enhanced or even maintained by the measures proposed by the review team?
- Why should the Parliament and the community wish to put at risk a highly effective audit model which has served Victoria well and embark upon a path which strips the Auditor-General of direct audit responsibilities and which would, in my opinion, lessen accountability?

I am more convinced than ever that the direction proposed by the review team will lead to a situation in which a future Parliament, if confronted by either an oppressive or corrupt government, would be relatively impotent and not privy to information which would allow it to call such government to account. This situation has already occurred in Queensland and Western Australia in recent years and required a substantial reassessment and strengthening of public accountability arrangements in those States.

As this matter has significant ramifications for democracy in Victoria and for future generations, I consider that, in order to maintain the supremacy of the Parliament and to protect the overall public interest, individual Members have an obligation to ensure politics do not intrude when deciding on any legislative change.

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May 1997

The Clerk of the Legislative Assembly
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Part 1



Executive Summary



Part 1.1

Major findings

1.1.1 Key findings arising from the audit reviews of ministerial portfolios are highlighted at the beginning of each individual section of this Report. **Major findings** are summarised below.

EDUCATION	Page 19
Financial management in schools	
<ul style="list-style-type: none">Given the level of school revenues derived from local communities (a net amount of \$97 million in the 1996 school year) it is evident that schools are, to some extent, reliant on this form of funding to supplement government funding for the provision of educational services. <i>Paras 3.1.11 to 3.1.14</i>It was found that 97 per cent of schools reviewed required parents to make voluntary contributions, with the average amount charged being \$70 per student. Despite the voluntary nature of these contributions, some schools, among other things, issued monthly invoices to parents until payment was made. <i>Paras 3.1.15 to 3.1.17</i>While under the schools for the future program, responsibility for financial management is transferred from the Department of Education to schools, audit found that 10 per cent of schools did not have a member on the council with an appropriate finance or business background. <i>Paras 3.1.29 to 3.1.35</i>As schools become more independent and responsible for the management of increasing levels of public resources (\$230 million cash and investments held by schools at December 1996), consideration needs to be given to increasing their level of accountability to the Parliament and ultimately to Victorian taxpayers. As the Parliament's auditor, it will be important that the Auditor-General is involved in this accountability process. <i>Para. 3.1.36</i>	
Property Management at RMIT	
<ul style="list-style-type: none">The Royal Melbourne Institute of Technology has underutilised and inappropriately utilised some of its property holdings. Accordingly, RMIT needs to place a greater emphasis on the rationalisation and maintenance of its existing property assets to ensure that the utilisation of properties held is maximised. <i>Paras 3.1.61 to 3.1.64</i>	



EDUCATION - <i>continued</i>	Page 19
Property management at RMIT - <i>continued</i>	
<ul style="list-style-type: none">• RMIT owns and manages in excess of 100 buildings which, together with land holdings, have a value of \$618 million, with 40 per cent of buildings in excess of 40 years of age. <i>Paras 3.1.37 to 3.1.39</i>• A review conducted by independent consultants during 1995 identified that \$125 million of necessary expenditure on safety, regulatory and building condition works over a 10 year period was required to bring RMIT's building stock to an acceptable standard. However, planned maintenance expenditure is substantially less than required. <i>Paras 3.1.43 to 3.1.48</i>• Internal reviews of utilisation levels have consistently established a compelling need for decisive action to redress the poor utilisation of teaching accommodation. <i>Paras 3.1.57 to 3.1.60</i>	
Management of grants in relation to adult, community and further education	
<ul style="list-style-type: none">• The Adult, Community and Further Education Board needs to develop standard criteria to be used in assessing service providers' submissions and tenders and require the formal documentation of evaluations, to ensure that funding allocations are soundly based and equitable. <i>Paras 3.1.72 to 3.1.79</i>	

HUMAN SERVICES	Page 59
Private practice arrangements	
<ul style="list-style-type: none">• While acknowledging that significant improvement had been made in the accountability arrangements for full-time medical officers participating in private practice activities in public hospitals, it was evident that problems persisted in relation to a number of long-standing arrangements. <i>Paras 3.2.12 to 3.2.15</i>• Due mainly to the reduction in the proportion of patients treated in public hospitals who are privately insured, there has been a significant decline in the level of funds that hospitals generate from private practice activities. <i>Paras 3.2.8 to 3.2.10</i>	
Delays in finalising health service agreements	
<ul style="list-style-type: none">• It was surprising to find that the unsatisfactory position brought to the attention of Parliament in 1992 regarding delays in finalising health service agreements has in fact deteriorated some 5 years later. <i>Paras 3.2.29 to 3.2.31</i>• Substantial delays occurred in the finalisation of health service agreements for both the 1995-96 and 1996-97 financial years. <i>Paras 3.2.32 to 3.2.39</i>	

INFRASTRUCTURE**Page 83****Local government**

- A significant proportion of councils failed to meet the legislated reporting deadline of 30 September.

Paras 3.3.4 to 3.3.12

- Consideration should be given to the disclosure within council financial statements of related party transactions of councillors and key council officers.

Paras 3.3.25 to 3.3.28

- Councils did not assess the potential benefits that could be achieved from applying municipal electricity undertakings privatisation proceeds of \$532.6 million to the elimination of their exposure to unfunded superannuation liabilities.

Paras 3.3.34 to 3.3.47

- An audit survey of major metropolitan and rural councils disclosed that most municipalities had not commissioned reviews of contaminated land and facilities prior to or after council amalgamations to enable the identification and management of associated risks.

Paras 3.3.48 to 3.3.62

- The sale price of \$32 million for the Market Square Centre by the City of Greater Geelong compared favourably with the book value of the Centre of \$28 million, but it should be recognised that the property was revalued downwards by \$4.1 million over the 3 years preceding the sale.

*Paras 3.3.63 to 3.3.81***Public transport**

- Over one million passengers were detected by the Public Transport Corporation during 1995-96 as travelling without a valid ticket.

Paras 3.3.95 to 3.3.96

- The estimated annual cost of fare evasion on suburban passenger trains was approximately \$10 million. Furthermore, surveys indicated that more than 80 per cent of offenders were not in possession of a ticket, with more than 60 per cent asserting that the station from which they had departed had not been staffed.

Para. 3.3.98

- It is envisaged by the Corporation that the automated ticketing system will be progressively implemented on the remainder of the transport system over a 12 month period, more than 2 years later than originally planned.

Paras 3.3.118 to 3.3.126



INFRASTRUCTURE - continued	Page 83
Public transport - continued	
<ul style="list-style-type: none">• Substantial delays were experienced in the finalisation of contractual arrangements between the Department of Infrastructure and the private sector provider of the Melbourne to Warrnambool passenger rail service which commenced in September 1993, with the support services agreement not signed until April 1997. <i>Paras 3.3.137 to 3.3.140</i>• While at the launch of the privately provided Melbourne to Warrnambool rail service it was indicated that the arrangement would result in annual savings to the State of \$3 million, the Department had not determined the extent of actual savings, if any, that have been achieved. <i>Paras 3.3.167 to 3.3.169</i>• The Department has not performed a post-implementation review of the contracting-out of the Melbourne to Warrnambool and Melbourne to Cobram services and accordingly there is a possibility that the experiences gained from these arrangements may not be factored into future privatisation proposals. <i>Para. 3.3.170</i>	
Urban Land Authority's treatment of project development fee	
<ul style="list-style-type: none">• Audit found it difficult to establish a direct link between the specific powers of the Authority, which mainly relate to the purchase and sub-division of land and the provision of associated infrastructure, and its treatment of a \$235 000 project development fee which was provided to the National Gallery of Victoria for the purchase of a painting. <i>Paras 3.3.174 to 3.3.178</i>	

JUSTICE	Page 133
Implementation of finance system at Country Fire Authority	
<ul style="list-style-type: none">• Following a tender and evaluation process, and after taking account of budgetary constraints, the CFA made a strategic decision to reject a new finance system from the preferred supplier and to implement a system that fell within its financial budget, but which would not meet its needs without additional work. <i>Para. 3.4.13</i>• System planning documentation was not prepared and approved until after key decisions had already been made, with the selected solution not fully supported by objective, detailed evaluations of the available options. <i>Paras 3.4.17 to 3.4.20</i>	

NATURAL RESOURCES AND ENVIRONMENT**Page 151****Asset holdings and recognition**

- While it is recognised that limitations may exist on the Department of Natural Resources and Environment's ability to increase rental charges and at the same time satisfy community expectations, scope appears to exist to improve financial returns for some of the Department's property holdings.

Paras 3.5.10 to 3.5.12

- In relation to a number of forest management areas, the Department is incurring costs to allow operators to remove native trees and wood products, with limited financial benefits accruing back to the State.

*Paras 3.5.13 to 3.5.15***Management of Crown land reserves**

- There is a clear need for the Department to review the current reporting framework relating to committees of management and trustees, to provide a proper functioning accountability process.

Paras 3.5.22 to 3.5.26

- The Department had not established a formal, systematic and risk based inspection program to ensure that Crown land reserves were not mismanaged or used for other than specified purposes.

*Paras 3.5.38 to 3.5.39***Reforms of alpine resorts**

- Given the sensitivity of environmental issues at alpine areas, particular attention will need to be given to the continued development of appropriate management plans and strategies to ensure the preservation of these unique areas for the benefit of future generations.

Paras 3.5.52 to 3.5.54

- Future site lease agreements need to be appropriately structured to ensure the collection of appropriate site rentals at the various resorts.

*Paras 3.5.57 to 3.5.62***Unaccounted water**

- During the 1995-96 financial year, water loss due to inaccurate customer meters cost the retail water companies in excess of \$~~10~~10 million.

Paras 3.5.77 to 3.5.83

- To assist in addressing water loss through leakage the retail water companies have recently implemented a program of accelerated infrastructure replacement.

Paras 3.5.90 to 3.5.91



TREASURY AND FINANCE **Page 203**

Local Authorities Superannuation Board - unfunded superannuation liabilities

- The unfunded superannuation liability of the Local Authorities Superannuation Board totalled \$329.1 million at 30 June 1996, an increase of \$111.5 million over the previous year.

Paras 3.8.4 to 3.8.9

- The major reason for the increase in the unfunded superannuation liability in the year was the higher than anticipated level of retrenchments prompted by the reform of Local Government, without a commensurate requirement being imposed by the Board on councils to immediately fund the additional superannuation costs.

Para 3.8.9 to 3.8.12

- Notwithstanding the adverse trend over an extended period, it was not until late 1996 that the Board responded to the fact that the emerging experience of the plan was at variance with the actuarial assumptions underpinning the funding position of the plan.

Paras 3.8.13 to 3.8.17

Financial standing of WorkCover

- While the WorkCover scheme has remained fully funded, its funding level decreased from 102.9 per cent at 30 June 1995 to 100.6 per cent at 31 December 1996.

Paras 3.8.18 to 3.8.26

- The WorkCover Authority has relied substantially on the transfer of \$320 million of surplus moneys from the Supplementation and Guarantee Funds to achieve and maintain the fully funded position of the WorkCover scheme.

Paras 3.8.34 to 3.8.39

- While the WorkCover scheme's financial position has stabilised, there are emerging claims cost pressures which will remain a key factor in the Authority's management focus to enable the Scheme to stay fully funded and to be in a position to maintain a competitive premium rate for employers.

Paras 3.8.40 to 3.8.42

Privatisation of Hazelwood and Energy Brix

- The successful bidder for Hazelwood was assessed as having the superior overall package as it exceeded alternative offers by a significant amount.

Paras 3.8.62 to 3.8.72

- The net benefit to the State from the sale of Hazelwood and Energy Brix, was \$1.5 billion after taking account of related costs, including estimated costs of sale of \$10 million.

Paras 3.8.73 to 3.8.77

- The State has provided financial support to Energy Brix of \$83.3 million since the 1993-94 financial year, including \$30.7 million mainly to fund future liabilities associated with the potential closure of the business.

Paras 3.8.82 to 3.8.84

TREASURY AND FINANCE - continued**Page 203****Privatisation of Hazelwood and Energy Brix - continued**

- The State only received \$8.9 million in relation to the sale of the Energy Brix business even though the reported book value of its net assets was recorded at \$28.7 million as at the date of its sale.
Para. 3.8.85
- On the basis of current Government projections, it is estimated that the State will derive on-going net savings of \$584 million per annum from the electricity privatisation that has occurred up to the date of preparation of this Report.
Paras 3.8.86 to 3.8.87
- In June 1996 the Treasurer issued a directive to Generation Victoria which effectively restricted its ability to freely compete in the wholesale electricity market, resulting in the under-utilisation of its gas entitlement under the gas supply agreement. Consequently, Generation Victoria was required to pay \$26 million for the unused portion of gas under the take-or-pay supply agreement.
Paras 3.8.94 to 3.8.100
- During the period July 1996 to March 1997, Generation Victoria only operated the Newport and Jeeralang power stations at an average utilisation rate of 7.9 per cent and 2.5 per cent respectively. Accordingly, the value of these power stations which is currently estimated at \$105 million needs to be re-assessed.
Paras 3.8.101 to 3.8.103

Petroleum Resources Rent Tax (PRRT) dispute settlement

- The PRRT dispute settlement arrangements which cost the State \$502 million, including legal and associated costs of \$43 million, represented a favourable outcome.
Paras 3.8.125 to 3.8.133
- Under new arrangements which will remain in operation until no later than December 2009, the State has accepted certain anti-competitive gas supply contractual arrangements and a significant take-or-pay obligation in relation to the annual nominated gas quantity that GASCOR is required to consume.
Paras 3.8.142 to 3.8.150

Reform of Victorian ports

- The redundancy packages available to port employees were on average 36 per cent higher than those available within the budget sector, with an estimated cost differential of \$8.1 million.
Paras 3.8.163 to 3.8.167



BROAD SCOPE ISSUES **Page 271**

Corporate governance in the public sector

- Consideration should be given to the introduction of a requirement for all public sector agencies to disclose within their annual reports a statement of the main corporate governance practices, similar to that required in the private sector.

Paras 4.1.14 to 4.1.18

Public sector financial reporting

- The implementation of whole-of-government reporting for the 1996-97 financial year will require a greater emphasis on ensuring improved consistency in financial reporting across the entire public sector.

Para. 4.2.7

State Government Corporate Card

- Almost 1 000 Corporate Cards had not been cancelled for up to 12 months after respective public sector agencies had been sold or abolished, unnecessarily exposing the State to financial risks.

Paras 4.3.18 to 4.3.19

- There is a need at the Departments of Justice, and Premier and Cabinet to strengthen the authorisation and verification procedures to ensure the probity and accountability of all Corporate Card payments.

Paras 4.3.24 to 4.3.39

The Year 2000 Issue - the Millennium Bug

- A significant issue confronting all organisations maintaining computerised systems is the capacity of date sensitive software and large databases to cope with the changes of dates from the year 1999 to the year 2000.

Paras 4.4.1

- Minimising the associated risks relies on the early review of computerised systems and, where necessary, the establishment of appropriate measures to ensure that such systems continue to correctly function beyond the year 1999.

Paras 4.4.6 to 4.4.7

Information technology security

- Agencies had not adequately assessed or quantified information security risks within their organisations.

Paras 4.5.18 to 4.5.22

- There was a lack of contingency planning at agencies which led to reduced assurance as to their ability to continue to deliver essential services to the public in the event of a disaster.

Paras 4.5.24 to 4.5.25

Part 2



Parliament of Victoria



Part 2.1

Parliament of Victoria

KEY FINDING

- The audit of the financial statements of the Parliament of Victoria proved satisfactory



PARLIAMENT OF VICTORIA

2.1.1 The audit of the financial statements of the Parliament of Victoria proved satisfactory.

**SCHEDULE A
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Parliament of Victoria	30 June 1996	No reporting requirements.	8 Nov. 1996	8 Nov. 1996

Part 3



Audit of Ministerial Portfolios



Part 3.1

Education

KEY FINDINGS

Financial management in schools

- At 31 December 1996, the 1 700 Victorian government schools held cash and investments totalling in excess of \$230 million, compared with approximately \$84 million held by schools at 31 December 1990.

Paras 3.1.4 to 3.1.10

- Cash and investment balances in excess of \$1 million were held by 8 schools as at 31 December 1996.

Para. 3.1.9

- Given the level of school revenues derived from local communities, (a net amount of \$97 million in the 1996 school year) it is evident that schools are, to some extent, reliant on this form of funding to supplement government funding for the provision of educational services.

Paras 3.1.11 to 3.1.14

- It was found that 97 per cent of schools reviewed required parents to make voluntary contributions, with the average amount charged being \$70 per student. Despite the voluntary nature of these contributions, some schools, among other things, issued monthly invoices to parents until payment was made and enlisted parents who had paid the levies to encourage other parents to make similar contributions.

Paras 3.1.15 to 3.1.17

- While under the schools for the future program, responsibility for financial management is transferred from the Department to schools, audit found that 10 per cent of schools did not have a member on the council with an appropriate finance or business background.

Paras 3.1.29 to 3.1.35

- As schools become more independent and responsible for the management of increasing levels of public resources, consideration needs to be given to increasing their level of accountability to the Parliament and ultimately to Victorian taxpayers. As the Parliament's auditor, it will be important that the Auditor General is involved



in this accountability process.

Para 3.1.36

KEY FINDINGS - continued

Property management at RMIT

- The Royal Melbourne Institute of Technology, which is now accorded University status, owns and manages in excess of 100 buildings which have a value of \$618 million, with 40 per cent of buildings in excess of 40 years of age. *Paras 3.1.37 to 3.1.42*
- A review conducted by independent consultants during 1995 identified that \$125 million of necessary expenditure on safety, regulatory and building condition works over a 10 year period was required to bring the University's building stock to an acceptable standard. However, the University's planned maintenance expenditure is substantially less than required. *Paras 3.1.43 to 3.1.48*
- Internal reviews of utilisation levels have consistently established a compelling need for decisive action to redress the poor utilisation of teaching accommodation. *Paras 3.1.57 to 3.1.60*
- The audit review found several parcels of accommodation which are within the University's area of strategic interest which currently do not contribute to its overall objectives as they are underutilised or inappropriately utilised. *Paras 3.1.61 to 3.1.63*
- The University needs to place a greater emphasis on the rationalisation and maintenance of its existing property assets to ensure that the utilisation of properties held by the University is maximised. *Para 3.1.64*

Management of grants in relation to adult, community and further education

- The Adult, Community and Further Education Board needs to develop standard criteria to be used in assessing service providers' submissions and tenders and require the formal documentation of evaluations, to ensure that funding allocations are soundly based and equitable. *Paras 3.1.72 to 3.1.79*
- Due to deficiencies in accountability arrangements with service providers, assurance was generally not obtained that grants had been appropriately expended in accordance with performance agreements. *Paras 3.1.83 to 3.1.85*
- To ensure probity over regional council operations, there is a need to reinforce members' responsibilities relating to issues of actual or potential conflicts of interest. *Paras 3.1.88 to 3.1.92*

3.1.1 Two Ministers, namely, the Minister for Education and the Minister for Tertiary Education and Training have responsibility for operations within the Education sector. These Ministers have collective responsibility for the Department of Education.

3.1.2 Details of the specific ministerial responsibilities for public bodies within the Education sector are listed in Table 3.1A. These public bodies, together with the Department of Education, were subject to audit by the Auditor-General during 1995-96.

**TABLE 3.1A
 MINISTERIAL RESPONSIBILITIES FOR
 PUBLIC BODIES WITHIN THE EDUCATION SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Education	Board of Studies Telematics Course Development Fund Trust
Tertiary Education and Training	Adult, Community and Further Education Board Council of Adult Education International Training Australia Pty Ltd Post-secondary education institutions: - universities (8) and associated companies, trusts and foundations (46) - colleges/institutes of technical and further education (23) State Training Board Victorian Tertiary Admission Centre

3.1.3 Comment on matters of significance arising from the audit of the Department of Education and public bodies within the Education sector is provided below.

FINANCIAL MANAGEMENT IN SCHOOLS

3.1.4 The Schools of the Future program, which commenced in 1993, represents a fundamental change in the way Victorian government schools operate. The key aim of the program is to improve the quality of student education by giving greater autonomy to school councils and principals in the management and allocation of resources in relation to each school. In addition, each school is responsible for developing, within broad guidelines set by the Department of Education, its own distinctive program to reflect the aspirations of the community it serves and the interests of its students.

3.1.5 While the Department provides each school with a global allocation of resources to meet costs associated with staffing, services, equipment and supplies, school councils have responsibility for the management and final allocation of all funds provided by the Department and those raised from the local community.

3.1.6 In relation to financial management matters, school councils have direct responsibility for:

- approving the annual budget;
- regularly monitoring expenditure to ensure that all funds are expended to achieve the aims of the school charter;
- approving requests to parents for voluntary school levies; and
- developing a marketing strategy.

3.1.7 As part of their management responsibilities, school principals are involved in overseeing the management of school budgets, the collection of voluntary levies and the regular reporting of financial outcomes to school councils.

Level of cash and investments held by school councils

3.1.8 At 31 December 1996, the 1 700 Victorian government schools held cash and investments totalling in excess of \$230 million, compared with approximately \$84 million held by schools at 31 December 1990, representing an increase of 173 per cent over this period. An analysis showed that 78 schools currently each control in excess of \$500 000, with 8 of these schools having cash and investment balances in excess of \$1 million.

3.1.9 Table 3.1B shows the schools which held cash and investments in excess of \$1 million at 31 December 1996.

TABLE 3.1B
SCHOOLS WITH SUBSTANTIAL CASH AND INVESTMENTS
AT 31 DECEMBER 1996
(\$)

<i>School</i>	<i>Amount</i>
Box Forest Secondary College	1 485 000
Mentone Girls Secondary College	1 415 000
Sandringham Secondary College	1 440 000
Templestowe College	1 377 000
Bendigo Senior Secondary College	1 150 000
Kyabram Secondary College	1 142 000
Mac Robertson Girls High School	1 029 000
Mooroopna Secondary College	1 017 000

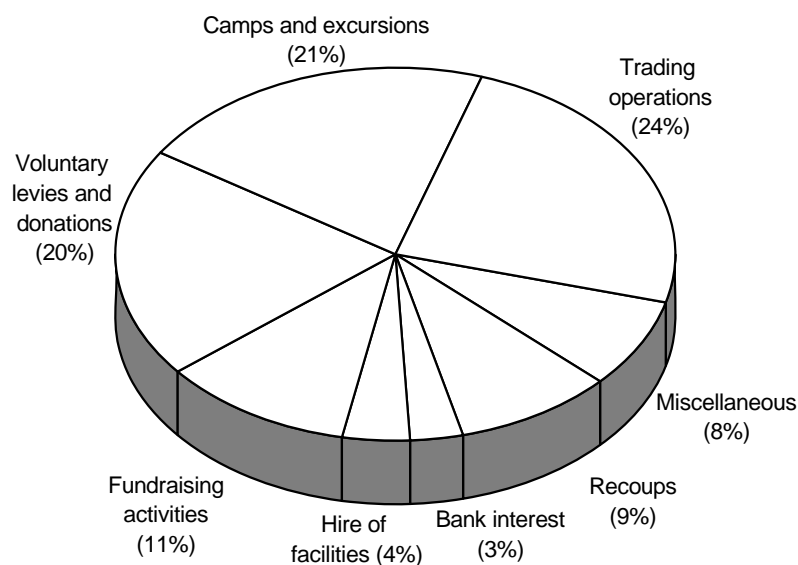
3.1.10 The major reasons for the improved cash position of schools were as follows:

- Fundraising by schools in the local community to assist in financing certain school initiatives. **In particular, Departmental records show that locally raised funds generated a net amount of \$97 million in the 1996 school year (representing 16.9 per cent of school operating revenue which does not include teacher salaries funding);**
- Government capital works grants and contributions by other bodies such as local government and community organisations which had not been applied by schools as the associated works were still in progress; and
- Additional special purpose government funding for new initiatives such as “Keys to Life, Sport and Physical Education, and Language Other Than English” programs.

Locally-raised funds

3.1.11 The analysis showed that locally-raised funds, during 1996 on average equated to a net \$186 per student, although considerable variations existed between schools. To generate locally raised funds, school councils engage in a diverse range of activities, with voluntary school levies and fundraising activities representing the major components of net revenues raised from the local community. Chart 3.1C illustrates the major sources of locally-raised funds, prior to taking account of associated costs.

CHART 3.1C
SOURCES OF LOCALLY-RAISED FUNDS, 1996 CALENDER YEAR (a)
 (per cent)



(a) Represents gross revenues (prior to associated costs including those relating to camps and excursions and trading operations).

3.1.12 Discussions with school principals indicated that the net receipts from locally raised funds were typically expended on:

- purchase of additional computer equipment;
- purchase of additional class materials;
- employment of specialist teachers;
- building and ground maintenance or repairs; and
- accumulation of working capital for future capital projects.

3.1.13 Given the level of school revenues derived from local communities, it is evident that schools are, to some extent, reliant on this form of funding to supplement government funding for the provision of educational services.

3.1.14 The ability of schools to generate locally-raised funds varies substantially depending on a number of factors including the type of school, socio-economic factors and the facilities available at individual schools, such as gymnasiums and halls. In relation to socio-economic factors, schools in areas with high levels of unemployment or non-English speaking parents generally had difficulties in raising such funds. However, in recognition of this, greater levels of government funding are provided to such schools through their global budget allocations.

3.1.15 As previously identified, voluntary levies are a key element of locally-raised funds, as unlike trading operations or camps and excursions there are few associated costs. **It was found that 97 per cent of schools reviewed required parents to make voluntary contributions, with the average amount charged being \$70 per student.** The ability to raise levies varied significantly between schools with audit identifying amounts ranging from \$50 per student (Sebastapol) to \$320 per student (Glen Waverley) for secondary colleges and \$50 per student (Cockatoo) to \$140 per student (Kew) for primary schools.

3.1.16 The audit also found that the average success rate for schools collecting these levies from parents was 70 per cent. **Despite the voluntary nature of these contributions, some schools, among other things, issued monthly invoices to parents until payment was made and enlisted parents who had paid the levies to encourage other parents to make similar contributions.**

3.1.17 It is the Department's policy that such levies are to be used for the purchase of books, class sets or other consumable items, and are not to be used on buildings or grounds. However, the audit review found that this policy was not always followed.

Capital grants

3.1.18 The Department conducted reviews of capital works projects in the 1993-94 and again in 1994-95 financial years, which highlighted a number of significant deficiencies with the planning and implementation of such projects, both at the departmental and school level. One of the key issues identified in the departmental review was the provision of grants to schools in advance of actual requirements, which resulted in schools holding large sums of money for extended periods of time and earning interest at rates less than what would have been obtained had the funds been held centrally.

3.1.19 An audit examination concentrating on the 1995-96 financial year indicated there had been some improvement in the timing of grants to schools as a result of departmental policy changes. However, 22 per cent of the schools reviewed were considered to have received grants significantly in advance of actual requirements, as cash flow projections were either inaccurate or not updated to reflect changes in the timing of the relevant projects.

3.1.20 Since 1993, most capital works projects have been managed at a school level with little departmental monitoring at the planning, implementation or post implementation stages, although the Department has conducted training programs to assist school staff in the management of these projects. However, audit found that:

- **most schools have little experience and administrative expertise in managing major capital projects; and**
- **heavy workloads experienced by many school business managers and other senior administration staff have meant that project management has not received the attention required.**

Management of cash and investments

3.1.21 According to the Schools of the Future Reference Guide, "*... schools must operate a bank account known as the official account as their main bank account. The official account must be used for the receipt of money provided from government sources and locally-raised funds*". School councils may also arrange and authorise the investment of surplus funds in approved investments.

3.1.22 With schools now holding higher levels of cash and investment balances, it is important to ensure that an effective control environment operates over these resources at schools. The nature of cash and investments increases the risk of fraud or misappropriation and accordingly, the Department's policy discourages the proliferation of non-essential bank accounts.

3.1.23 The audit review found that many schools operated what is considered to be an excessive number of bank and investment accounts. It was apparent that some schools were operating separate accounts for each project or activity. The proliferation of these accounts clearly results in inefficient and uneconomic cash management practices, and increases the associated risk of misappropriation and fraud.

3.1.24 Further, the Department of Education guidelines state that "*Under no circumstances should bank accounts be overdrawn or cheques knowingly drawn*

on a bank account where there are not sufficient funds to meet the payments". However, the review found that 6 per cent of schools had gone into overdraft within the past calendar year. It was considered that inadequate cash flow budgeting and reporting during that year was a contributing factor in many schools where this occurred.

3.1.25 Attention needs to be given to the development of improved budgeting and cash flow estimation techniques at schools to ensure compliance with the Department's cash management policies.

Recording of financial information at schools

3.1.26 A key element in the implementation of the Schools of the Future program is the provision of an information system to support local decision-making, accountability requirements and the improvement of school administrative processes. Schools are required to use a computerised system known as the Computerised Administrative Services Environment for Schools (CASES), to record all details of income and expenditure, personnel data, fixed assets and bank accounts. The CASES system interfaces with the Department.

3.1.27 Audit found that this system was not, in all cases, fully maintained by the schools, with incorrect classification of grant transactions and significant variances between cash and investments recorded on the system compared with that actually held by individual schools.

3.1.28 In order to realise the anticipated benefits in the form of improved financial management and effective decision-making from the operation of this information system, it is important that the information recorded on the system is both complete and accurate, and that administrative staff are provided with adequate training and support.

Control environment at schools

3.1.29 The *Schools of the Future Reference Guide* provides that a major responsibility of school councils under the *Education Act 1958* is to ensure that all moneys received by the school are used for proper purposes. Furthermore, school councils have responsibility for ensuring that the annual budget statements are prepared and that statements of receipts and expenditure for each calendar year are prepared and audited with these statements forwarded to the Department of Education. To assist in the effective management of school operations, the Department recommends that a 3 year forward plan also be prepared by school councils and that at each council meeting financial reports be presented and endorsed.

3.1.30 Audit found that **10 per cent of schools did not have a member on the council with an appropriate finance or business background, and that 17 per cent of councils did not regularly review financial reports indicating progress against budget.**

3.1.31 In the absence of adequately skilled council membership and effective financial monitoring there is a risk that school finances may not be managed in the most efficient and effective manner. Accordingly, the Department should encourage school councils to invite people with financial expertise to stand for appointment to the councils.

3.1.32 The need for a strong internal control environment at schools has increased with greater devolvement of responsibilities to school councils. The Department has acknowledged this need and released an internal control booklet as a reference to all school principals and business managers to assist in the identification of control risks and the development of appropriate strategies to address these risks.

3.1.33 The Department obtains comfort on the control environment established at individual schools through the annual financial audit process. This process, which is in the nature of an internal audit function, involves the engagement by the Department of private sector accounting firms to undertake audits of all primary and secondary schools and report back to the Department.

3.1.34 This internal audit function has identified various internal control deficiencies at schools, including:

- failure to maintain adequate controls over accountable documents;
- students not issued with receipts for significant amounts of money paid to the school;
- inadequate controls over significant purchase orders and requisitions;
- payments on the basis of faxed, photocopied or duplicated invoices;
- bank reconciliations not independently reviewed;
- payments made not ratified by school councils; and
- lack of segregation of duties among administrative staff.

3.1.35 The Department needs to continue to ensure that school principals and councils are made aware of the need to maintain an adequate system of internal control and be provided with ongoing advice as to minimum requirements and best practice.

3.1.36 Furthermore, as schools become more independent and responsible for the management of increasing levels of public resources, consideration needs to be given to increasing their level of accountability to the Parliament and ultimately to Victorian taxpayers. As the Parliament's auditor, it will be important that the Auditor-General is involved in this accountability process.

□ **RESPONSE** provided by Secretary, Department of Education

Level of cash and investments held by school councils

Over the years 1992 to 1997, cash grants to schools for both recurrent and capital purposes have increased significantly. In the financial year 1996-97, some \$437 million will be paid to schools for general operating, cleaning, maintenance and capital purposes etc. In the financial year 1991-92, by comparison, the level of cash grants to schools was \$146 million. Clearly, the better cash positions of schools as reflected in higher levels of cash and investment as at 31 December 1996, is a direct result of the Government placing more resources in schools under the Schools of the Future program.

The \$97 million of locally-raised funds by schools, as mentioned in the Auditor-General's Report, should be seen in the context of the \$459.7 million of government grants and allowances (not including salaries) paid to schools in the 1996 school year. If account is taken of salary funding, which typically represents 85 per cent of schools operating costs, the contribution of local fundraising represents, on average, around 5 per cent of schools' operating costs.

Locally-raised funds

The recent work carried out in the Department indicates that in addition to the core element in the School Global Budget, in excess of \$80 million is provided to schools under the Special Learning Needs, English as a Second Language and Rurality and Isolation programs. The Departments review showed that these programs fully compensated the lower levels of fundraising (via voluntary levies) by schools in socio-economically disadvantaged areas.

While local fundraising is important to schools, the fact that the Government's non-salary cash grants to schools has increased substantially, compared with the previous Government, and the fact that the level of local fundraising is around 5 per cent of the level of government-provided salaries and non-salaries funds, the strong indication is that local funds supplement government funding for discretionary educational services.

While the Department would confirm the voluntary nature of fees and levies by schools, the annual charges mentioned in the Auditor-General's Report reflect \$1.25 per week at Sebastapol and Cockatoo, and \$3.50 per week at Kew and \$8.00 per week at Glen Waverley Secondary College.

The suggestion that schools are reliant on voluntary levies and make a significant contribution to revenue is not accurate. It must be stressed that the voluntary levies policy is unchanged from the previous governments. During the period 1993 to 1997 the government funding of Education Maintenance Allowance also increased from \$28 million to \$34 million.

The Schools of the Future Reference Guide which has been issued to all schools states:

"Schools must recognise the government's commitment to the voluntary nature of parent/guardian contributions. It is important that such contributions are kept at a reasonable level and are within the expectations of the school community. It is equally important that the basis and services provided for any contribution is fully understood by all parents/guardians and that any practice is sympathetic to the circumstances of individual students and parents/guardians.

□ **RESPONSE** provided by Secretary, Department of Education - continued

“It would not be appropriate for:

- *students to be denied access to the standard educational program of their school;*
- *information about student progress to be withheld from students and their families;*
- *schools to impose fees for buildings and ground maintenance and beautification; and*
- *schools to impose a charge for use of the library.*

“School councils cannot levy parent/guardian contributions as a condition of student access to the standard educational program or for the reporting of student progress.”

Parents who feel aggrieved by local arrangements have been encouraged to take the matter up with the Regional General Manager for resolution.

Capital grants

While the Schools of the Future concept is relatively new, it needs to be understood that School Councils have been undertaking capital refurbishment and upgrade programs since the early 1980s, under the School Council contracts program hence, Schools Councils have had long experience in arranging and monitoring capital works programs. In addition:

- *DOE developed guidelines to assist school business managers and principals in managing capital grants. These guidelines cover issues including the financial management of projects, School Council Procedures, Tendering, Legislative requirements, consultants services and risk management. They are updated regularly on at least an annual basis or more frequently if major policy changes occur.*
- *Actual support for schools in planning and managing their projects through briefings, training sessions and on a project-by-project basis as personal time allows or on an on-call basis. Schools are also provided with funds to allow them to employ architects, building consultants, surveyors etc. to manage/advise capital programs. Consulting architects, in particular, provide School Councils with cashflow projections and other accountability data which form the basis for overall project control. In order to improve the actual timing of payments, regions highlight the issues involved when assisting schools and follow-up phone calls are often required as the program is monitored Statewide.*
- *It has also been recognised that there is continuous demand for administrative support for schools to meet the demands, \$30 million has been provided since the beginning of 1995 for additional administrative support staff in schools. The Department has recently engaged consultants to examine and make recommendations on the level of support required.*

PRMS (Physical Resources Management System) is currently being developed for schools. This program will assist schools in prioritising and managing maintenance and capital works projects.

□ **RESPONSE** provided by Secretary, Department of Education - continued

Management of cash and investments

Department of Education policy is very clear when it comes to the operation of school bank accounts. This policy was reinforced in the Schools of the Future Reference Guide (Section 7.5.1.1) which has been issued to all schools. The Department's policy is for schools to operate one official bank account. During 1996 the Department's Financial Services Branch conducted a number of workshops throughout Victoria titled "Basic Accounting Principles", which covered School Bank Accounts.

It should be noted that pursuant to Education Regulations 1988, Part 9, School Councils can open up separate bank accounts for the following purposes by the DOE:

- *moneys held in trust;*
- *co-operatives; and*
- *welfare clubs.*

The Department's Financial Services Branch is currently conducting workshops on the "Preparation of a Cash Flow Budget". Approximately 12 sessions have been conducted and a further 30 sessions are committed for 1997 throughout Victoria and it is expected some 850 principals and business managers will participate in these sessions.

During 1996, "Preparation of School Level Budget" workshops were provided to schools. Financial Services Branch has once again offered this activity for 1997 and the current programs are again fully subscribed. The Department is committed to ensuring the principals and business managers have access to professional development activities which incorporate best practice strategies.

Recording of financial information at schools

The variation occurred in 1996 and was detected by the Department's internal audit. Management took steps to advise schools of the correct procedures and we expect that in 1997 financial statements of schools will be an accurate reflection of cash and investment balances across the system. In relation to incorrect coding classifications, the school level chart of accounts is published annually to assist schools with correct charging codes.

Correct classification of receipts and payments is included in the "Basic Accounting Principles" workshop which was conducted throughout 1996 and has been offered during 1997.

The Department fully supports the principle of presenting financial information with correct classifications and has been and continues to be proactive in this area.

□ **RESPONSE** provided by Secretary, Department of Education - continued

Control environment of schools

A more positive way of expressing the Auditor-General's comments would be to say, 90 per cent of School Councils have a member with a finance or business background and 83 per cent of Councils regularly review financial reports against budget. This is a pleasing result for the Department of Education to have such a high community involvement of school councillors with the appropriate finance or business background. It is also to be expected that small schools in isolated areas will have difficulty in attracting people with finance or business background.

The Department recognises that it would be advantageous to increase financial expertise on School Councils; at present this is a School Council decision.

In 1995, the Department developed a comprehensive book on best practice internal control which is in all schools and is used extensively.

In addition, where audit reports suggest a school has significant internal control weaknesses, the Department draws this to the attention of the School Council via the regional General Manager (Schools). Further, the school is listed for an early audit in the following year to ensure the problem has been corrected.

A series of "Internal Control" workshops were conducted during 1996. Further workshops have been offered to schools. It is intended this will be an ongoing professional development activity.

It is proposed to release additional publications to all schools covering internal control issues.

In addition to the above activities and publications, the DOE has offered the following financial management activities to all schools:

- cash management for schools;*
- administration of school level payroll;*
- induction program for new principals;*
- introduction to school financial management; and*
- accounting for school trading operations.*

The Auditor-General has always been kept fully informed of accountability developments in schools. The Auditor-General is contracted to DOE for the audit of 4 schools and in that capacity has the direct opportunity to evaluate the quality of the audit program, the quality of DOE follow-up, the quality of training, guidelines etc. The Auditor-General is also provided with internal audit reports, reports of DOE Audit Committee meetings and all contract audit reports on schools.



PROPERTY MANAGEMENT AT THE ROYAL MELBOURNE INSTITUTE OF TECHNOLOGY

3.1.37 The Royal Melbourne Institute of Technology was originally established in 1887. However, under the *Royal Melbourne University of Technology Act* 1992 the Royal Melbourne Institute of Technology was merged with the Phillip Institute of Technology and was accorded University status. The University, known as the Royal Melbourne Institute of Technology, is now a multi-sector institution with enrolments of around 43 000 students, situated on a number of central city and suburban campuses and sites. The University offers a range of courses in the TAFE and higher education sectors ranging from pre-vocational training to associate diplomas, degrees and doctorates.

3.1.38 The University undertakes 3 inter-related business activities, namely:

- education and training;
- research and development; and
- international programs.

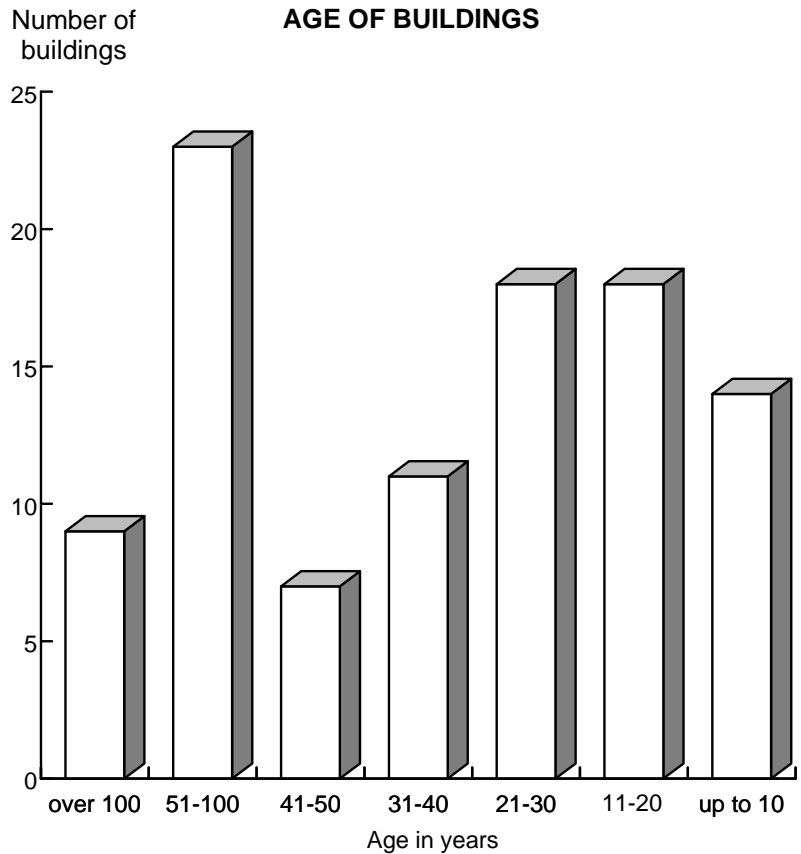
3.1.39 In carrying out its activities, the University owns and manages in excess of 100 buildings which have a value of \$618 million, including the value of associated land. The properties are mainly located in the Melbourne central business district and in the suburbs of Carlton and Bundoora. Table 3.1D indicates the properties held at the various campuses.

**TABLE 3.1D
PROPERTY PORTFOLIO**

<i>Property location</i>	<i>Gross floor/ vacant land area</i>	<i>Independent valuation 1995</i>
	('000m ²)	(\$m)
Melbourne campus	168	356
Carlton campus	62	122
Bundoora campus	573	91
Brunswick campus	71	21
Miscellaneous	28	28
Total	902	618

3.1.40 The age and condition of the University's buildings vary significantly as do the roles they fulfil. Chart 3.1E illustrates the age profile of the University's buildings.

**CHART 3.1E
AGE OF BUILDINGS**



3.1.41 The chart shows that approximately 40 per cent of the University’s buildings are over 40 years of age.

3.1.42 The University’s Asset Management Group is responsible for the planning, design, construction and maintenance of the physical infrastructure and environment of the University. The Group’s role is to identify the capital needs of the University and to review its current physical assets and proposed capital funding in light of:

- changes in teaching and learning activities; and
- emerging trends and strategic targets.

Strategic planning

3.1.43 The University established an integrated planning process, the cornerstone of which is the University's strategic plan. The plan articulates the University's mission, goal, values and underlying business strategies, and provides the framework for a series of complementary and integrated strategies and plans for the University's core businesses and support activities. The plan covers a 5 year period and incorporates an annual cycle of planning, implementation, reporting and review.

3.1.44 A number of existing strategies within the plan directly impact on the University's physical infrastructure requirements, including a strategy to increase the student load at the Bundoora campus by the year 2000.

3.1.45 Other key documents within the established strategic planning framework, which impact upon property management, include:

- the capital management plan; and
- the performance plan for the Asset Management Group.

3.1.46 While the current draft capital management plan for the years 1996 to 2000 outlines the immediate physical resource needs of the University and how these needs are to be met in the context of the University's strategic plan, it does not articulate the strategy beyond five years for the development of University's physical infrastructure. Audit was advised that the Asset Management Group is in the process of developing such a plan. In addition, the Group has proposed a new capital planning process. The University had previously commissioned a review of facilities by consultants which led to the sale of the Coburg campus and conducted an internal review resulting in a physical master plan for the Bundoora campus.

3.1.47 The University's strategic plan highlights inadequate or aging infrastructure and amenities as an issue requiring attention. It also acknowledges that students perceive major deficiencies in the University's physical facilities and student amenities, representing a significant vulnerability for the University in an era of increasing fee-paying activity. Audit was advised that this problem is common to most Australian Universities and is a reflection of the age of the University's buildings. The University's draft capital management plan also recognises:

- a substantial maintenance backlog, which has been accumulated over the last 15 to 20 years;
- relatively poor accommodation standards when compared with established regulatory and community expectations;
- poor utilisation of teaching space at both main campuses;
- lack of flexibility in building stock; and
- failing associated infrastructure, such as plumbing.

3.1.48 A review conducted by independent consultants during 1995 identified that \$125 million of necessary expenditure on safety, regulatory and building condition works over a 10 year period was required to bring the University's building stock to an acceptable standard. Of this amount, \$80 million was identified as expenditure needed to be incurred prior to the year 2000. However, the draft capital management plan for the years 1996 to 2000 currently provides for substantially less than the recommended works.

Management information and performance management

3.1.49 The University has undertaken a number of substantial initiatives to enhance information available on its physical infrastructure for management and planning purposes including:

- maintenance of a space inventory and introduction of a space planning model;
- implementation of a new room booking system;

- introduction of an occupancy charge-back system; and
- adoption of a “client focus” by the Asset Management Group with enhanced performance monitoring and measurement in respect of its property management activities.

Space inventory and planning model

3.1.50 The University maintains a space inventory in the form of a database, which contains details of all buildings and rooms within the University and their occupants. In response to concerns raised by the University’s internal audit on the accuracy of this database, at the time of preparation of this Report, the University had almost completed verifying accommodation details, together with updating information used for ancillary purposes.

3.1.51 The space inventory data is intended to be used in a space planning model to predict future accommodation requirements for the University. This model will replace the University's existing floor space projection system and is intended to facilitate a client focus to accommodation planning and management, while maintaining a University-wide strategic planning perspective linked to the University's teaching and learning strategies. The model is expected to provide timely, detailed, cost-effective and responsive planning and management information for decision-making purposes at all levels.

Room booking system

3.1.52 The University operates a computerised room booking system which provides a centralised means of co-ordinating the allocation of available teaching accommodation between faculties, and provides information to assist in the planning of future accommodation requirements and the management of existing accommodation. A new, campus-wide room scheduling system is to be implemented by July 1997 to improve the utilisation of existing facilities.

3.1.53 Audit found that **only 10 per cent of teaching facilities are included on the central room booking system.** Consequently, the University’s ability to ensure the efficient and effective use of its accommodation is restricted. Audit was advised that the University plans to increase the quantum of teaching facilities on the system. However, while the inclusion of a significantly higher proportion of teaching facilities on the system will enhance the University’s ability to improve utilisation, it will not of itself resolve the utilisation problems confronting the University.

Occupancy charge-back system

3.1.54 The University is in the process of introducing an occupancy charge-back system for property, under which, once fully implemented, departments within the University will bear accommodation-related operating costs, including cleaning, power, security, plant and building maintenance and external lease costs where appropriate, and certain overheads. This represents a significant initiative by the University.



3.1.55 The major objective of the system is to encourage improved utilisation of space, thereby freeing-up funds currently locked in physical assets for other purposes and improving the overall quality of accommodation remaining in use. The initial trial phase of the new occupancy charge-back system commenced in January 1997, with full implementation planned for 1998.

3.1.56 The audit review of the new system concluded that while the new system once fully implemented will facilitate improved cost attribution, it does not provide cost penalties for the inappropriate use of accommodation, and therefore may not result in departments within the University rationalising existing surplus accommodation and improving utilisation.

Property utilisation

3.1.57 In order to assess the extent to which property assets are being utilised by the University, audit considered the findings and action arising from the internal reviews of room utilisation and independently undertook investigations of the utilisation of selected University accommodation. The utilisation of properties has been considered in the light of the asset's potential capacity and the extent to which its current usage contributes to the University's mission and goals.



RMIT City campus.

Internal reviews of utilisation levels

3.1.58 The University has conducted internal reviews of room utilisation on 4 separate occasions, with the most recent in September 1996. In addition, at the time of preparation of this Report, a further review was being undertaken. These reviews were conducted across a broad range of teaching facilities at the City, Brunswick and Bundoora campuses to enable the University to develop a better understanding of the use of its teaching facilities and to assist in decision-making concerning existing and future accommodation needs. The reviews assessed room utilisation during weekdays covering the times of 8.30 a.m. to 9.30 p.m.

3.1.59 While these reviews applied sampling techniques that can be statistically challenged, nevertheless they have established **an overwhelmingly consistent view that University teaching space was poorly utilised**. In particular, the most recent review found that:

- **the average utilisation for teaching space was 16 per cent for September 1996** compared with an average utilisation standard established by the internal reviews of approximately 44 per cent;
- computer laboratories had a high utilisation rate, at around 31 per cent for September 1996 compared with an average utilisation standard established by the internal reviews of 37.5 per cent;
- **general teaching spaces had a utilisation rate of only 13 per cent for September 1996** compared with an average utilisation standard established by the internal reviews of 52.5 per cent;
- **other laboratories had a utilisation rate of only 14 per cent for September 1996** compared with an average utilisation standard established by the internal reviews of 37.5 per cent; and
- **in 54 per cent of cases where rooms were booked, during the September 1996 period when the internal review was undertaken, the rooms were not actually used.**

3.1.60 The findings of these internal reviews have progressively established a compelling need for decisive action to redress property utilisation problems. While the various previously mentioned initiatives introduced by the University provide a starting point towards improved property management, greater progress may be achieved by strengthening the occupancy charge-back system.

External review of property utilisation

3.1.61 The audit review found **several parcels of accommodation which are within the University's area of strategic interest which currently do not contribute to its overall objectives as they are underutilised or inappropriately utilised**. These parcels of accommodation are summarised in Table 3.1F. This review did not cover accommodation examined as part of the internal review of room utilisation and therefore extends the level of underutilised and inappropriately utilised properties under the University's management.

TABLE 3.1F
ACCOMMODATION CURRENTLY NOT CONTRIBUTING TO THE UNIVERSITY'S OBJECTIVES

<i>Property and value at December 1995</i>	<i>Current usage</i>
Former bicycle factory, 16 Cardigan Street, Carlton (valued at \$305 000)	The building consists of 2 floors with part of one of the floors used to store library books while the remaining area is vacant. Audit was advised that the University will consider this site as part of future property development planning.
Vacant land, 24-26 Orr Street, Carlton (valued at \$201 000)	This property is currently used as a carpark and there are currently no plans for development of the site. Audit was advised that the University will consider this site as part of future property development planning.
Kay House, 449 Swanston Street, Melbourne (valued at \$6.4 million)	In relation to this property, 1 051 square metres of its total building space of 6 196 square metres is commercially tenanted. In addition, 1 003 square metres, comprising the building's basement, has been predominantly vacant since 1995.
Gateway House, 459 Swanston Street, Melbourne (valued at \$1.8 million)	Around 579 square metres of the building's total area of 1 643 square metres is leased to commercial tenants.
Oxford Scholar Hotel, 429-43 Swanston Street, Melbourne (valued at \$1.9 million)	While the hotel is leased to a private licensee, it does not contribute to the University's overall objectives. Audit was advised that the hotel may form part of the proposed Swanston Sports and Information Technology Complex.
Carpark and newsagency, 435 Swanston Street, Melbourne (valued at \$4.3 million)	The property predominantly comprises a public carpark operated by the University, however, a small building on the site is occupied by a commercial tenant. The University has approved in principle the construction of the Swanston Sports and Information Technology Complex on this site for its purposes.
410 Elizabeth Street, Melbourne (valued at \$6.3 million)	The ground and first floor of this 7 floor building is leased to commercial tenants.
Industrial building, 26 Cardigan Street, Carlton (valued at \$403 000)	A portion of the building had been leased to a commercial tenant with the remaining space used for storage. The University is considering extending the use of this property for storage and other purposes.

3.1.62 The challenge for the University in the management of its property portfolio is to balance its longer-term strategic needs against the cost of holding underutilised or inappropriately utilised properties. The associated opportunity cost is best represented by the substantial amounts of funds that are tied-up and unavailable for academic or research purposes, and for the funding of the backlog of property maintenance.

3.1.63 Audit found that the University’s Council had approved, or approved in principle, the acquisition of certain additional accommodation space at a number of locations, including the construction of the Swanston Sports and Information Technology Complex for the University in Swanston Street, Melbourne.

3.1.64 The University needs to place a greater emphasis on the rationalisation and maintenance of its existing property assets to ensure that the utilisation of properties held by the University is maximised.

RESPONSE provided by Vice-Chancellor, Royal Melbourne Institute of Technology

RMIT disagrees with many of the opinions and conclusions reached in the Auditor-General’s Report. The statements made in the Report demonstrate a poor understanding of contemporary property management best practices and the unique nature of RMIT’s operating environment. The Report adds little or no value to the property management processes of the University as all of the matters highlighted have been previously identified internally and are in the process of being addressed or have already been addressed. In fact, RMIT’s management of its physical infrastructure is at the forefront of international best practices. RMIT’s response to a number of the opinions and conclusions reached is given below.

1. *Articulation of the longer-term strategy for the University’s physical infrastructure*

In addition to the University’s 5 year capital management plan the RMIT Asset Management Group have prepared a Strategic Plan for the Group with a 10 year outlook. This plan clearly articulates a long-term strategy for the management of the University’s physical infrastructure. A major outcome, foreshadowed in the draft Strategic Plan, will be the implementation of a 10 year Capital Management Plan covering the development of the University’s physical infrastructure to the year 2007.

The Report refers to the 1993 Strategic Facilities Plan prepared by external consultants which considered the facilities needs of the University within a 7 year horizon. For example, this review recommended that the Coburg campus not be retained for undergraduate programs. This campus has now been sold and the program relocated. A further internal review of the Bundoora Campus accepted by Council in 1996 also provides an indication of the best use of the campus for in excess of a 10 year horizon by way of a physical Masterplan. It also makes reference to long-term development of the Janefield precinct. This is potentially a 50 year development. Similar work is progressing on the long-term development of the City campus, noting the peculiarities of a University in the city and providing a basis for the establishment of a strong relationship now being fostered with the City of Melbourne.

2. *Capital Management Plan - funds allocated to safety, regulatory and building condition works*

RMIT has dedicated approximately \$35 million of funds within the University’s Capital Management Plan to safety, regulatory and building condition works between 1996 and the year 2000. While this is less than the amount recommended by the consultant’s review, it provides for essential safety and regulatory work to be done.

□ **RESPONSE** provided by Vice-Chancellor, Royal Melbourne Institute of Technology - continued

In addition, a further \$25 million will be expended on identified building condition works over the next 10 years as a part of major projects undertaken by the University.

As indicated in the Report, RMIT has a significant number of buildings in excess of 30 years old, including a number of heritage listed buildings. The issue of accumulated maintenance of this building stock has been recognised by other Victorian Government bodies, such as the Office of Training and Further Education, who have changed their capital planning strategies to reflect the requirement to address the maintenance issue. In any event, RMIT has taken a proactive approach to addressing the problem. It employed independent consultants to assess the extent of the problem in 1995 and then instituted a planned program of activity in response to their report.

In the current climate of government funding reductions and fiscal restraint, it is not possible or prudent to provide the level of funds that would enable all work identified by the RMIT review to be carried out in a relatively short time frame. In providing \$35 million, RMIT has made a substantial and fiscally responsible commitment towards addressing its obligations in maintaining its physical asset base.

The response by RMIT to the problem of safety, regulatory and building condition works is both fiscally responsible and, in an asset management sense, well planned.

3. Teaching facilities included on central room booking system

The Report states that, because only 10 per cent of teaching facilities are included on the central room booking system, RMIT's ability to efficiently and effectively use space is restricted. This statement ignores the approach taken by RMIT and the specialised nature of a large number of teaching facilities within the University.

Central control does not automatically equate to efficient or effective practices. RMIT has thoughtfully adopted a decentralised model in control of teaching spaces. This is to enable both responsibility in the use of resources at a user level and flexibility of use. RMIT's strategies to underpin this approach include the development of occupancy chargeback and the introduction of service agreements and the twice yearly room audit surveys. It is perplexing that, while these strategies are seen as substantial initiatives in the Report, the link between these strategies and RMIT's approach to accommodation management has been missed by the audit team. RMIT is pursuing a client-services approach in its asset management. To return to the old philosophy of central control would be a significant backward step, contrary to best practice, and in our considered opinion would serve no long-term useful purpose.

The Report does not acknowledge that a University contains a significant number of dedicated teaching facilities such as laboratory areas and rooms containing specialist equipment. These areas are not suitable for central control. It is not possible for these types of teaching facilities to be utilised for other purposes. In many instances to do so would place students and staff in an inappropriate and unsafe environment. There are also a small number of rooms nominated as "home rooms" for particular courses involving students requiring specialised support. It would be both

EDUCATION

inappropriate and inefficient to place these facilities in a central control environment.

□ **RESPONSE** provided by Vice-Chancellor, Royal Melbourne Institute of Technology - continued

A new room booking system is to be introduced throughout the University in the second half of 1997. This system will provide each Faculty or Group with access to room booking information on the facilities under their control. It will also provide information on facilities utilisation across the University for the Asset Management Group. The room booking system, in combination with the introduction of occupancy chargeback, reinforces the devolvement of teaching facility management to the Faculties and Groups by giving them access to the tools they need to better manage their facilities. This is an essential component of the client service approach being adopted by RMIT.

4. *Occupancy charge-back system - rationalising accommodation and improved utilisation.*

RMIT acknowledges the “positive” recognition that the introduction of an occupancy charge-back system is considered to be a “significant initiative” by the University. It is therefore disappointing that the Report fails to recognise the level of planning and preparation that had been entered into by the University in developing and implementing the system. RMIT is the only University in Australia to have gone down the path of introducing a space charge-back and, as such, we would have expected the Report to be more supportive of our initiatives in this area.

The occupancy charge-back system being introduced by RMIT is the result of extensive research into how universities and major institutions manage their space. After examining various approaches to the occupancy charge-back problem, a visit was arranged to sites in the United Kingdom and the United States of America where the use of occupancy charge-back had been successful, both in increased efficiency and in acceptance by the client group. RMIT is satisfied that the system being introduced represents best practice both within Australia and overseas.

It is inappropriate that cost penalties should be used to force the rationalising of accommodation as suggested by the audit team. International research demonstrates that where occupancy charge-back has been introduced, that incentives, rather than penalties, have been extremely effective in providing for improved space utilisation. The use of penalties would also represent a significant impediment to the development of a service culture within the management of accommodation within the University. RMIT has made allowances that some fine tuning of the model introduced may be required on a phased basis following progress reviews, however, this will be on a planned and managed basis to best support the continuing operating and strategic directions of the core business of the University.

5. *Utilisation of accommodation*

The Auditor-General’s Report notes utilisation figures provided by RMIT from utilisation studies conducted in September 1996. The University identified utilisation as an area for improvement in 1994. After quantifying the problem, RMIT has moved swiftly to introduce regular utilisation audits, occupancy chargeback, new room booking system and development of a new space planning model, are all initiatives introduced by the University to improve its efficient use of space. The audit team acknowledged these initiatives. RMIT expects a marked improvement in its use of space in 1998 and 1999 as a result of introducing these initiatives.

□ **RESPONSE** provided by Vice-Chancellor, Royal Melbourne Institute of Technology - continued

The report relies on RMIT's reports without adequate explanation or attempt to place the results in context. The figures quoted are based on a straight averaging of all space over a possible usage of 13 hours per day. This disregards a number of significant factors, for example:

- *The core business of the University is conducted over a 26 week period between the hours of 8.30 a.m. and 5.30 p.m.;*
- *As the audit team recognised elsewhere in the Report, RMIT has significant space holdings which, due to the standard of accommodation or lack of flexibility, are inappropriate. The Capital Masterplan is addressing this problem; AND*
- *Specialist facilities, that are not capable of being used for general use, are included within the audit.*

The room audit process at RMIT is not merely intended to provide a straight average utilisation figure. It is a complex tool that is used to inform policy decisions, identify areas for improvement, and provide a means of measuring performance at a Faculty or Group level. The Report fails to acknowledge the purpose of the RMIT audit process, or adequately set the figures quoted into context, is misleading.

6. *Property utilisation*

RMIT totally disagrees with the implication that the properties listed within the Report, in the table are "currently not contributing to the University's objectives". This ignores the strategic importance of a number of properties, particularly those in the block bounded by Swanston, Franklin, Elizabeth and A'Beckett Streets. Moreover, the need for planned additions to the open space, in order to create a more hospitable environment, has not been acknowledged.

The Report on one hand criticises RMIT for a perceived lack of longer-range planning, yet, where property has been acquired that will facilitate the University's longer-term capital master plan, the long-term planning is not acknowledged but criticised without foundation. The data contained in the table does not include any evidence to support the incorrect conclusion reached by the audit team. (In any case, the value of properties listed in the table represent only 3 per cent of RMIT's total land and building stock).

The Government has generally not assisted RMIT with the acquisition of properties to enable the construction of TAFE facilities in the city. The University has had to overcome this burden to provide appropriate educational facilities. Similar justification exists for the properties purchased for Higher Education requirements. In reply to specific comments made by the Report on RMIT's management of property, the following details should be noted:

□ **RESPONSE** provided by Vice-Chancellor, Royal Melbourne Institute of Technology - continued

Property and value as at December 1995	Explanation
Former bicycle factory, 16 Cardigan Street, Carlton valued at \$305 437	Current use: Storage The property has been purchased in accordance with the approved TAFE Master Plan. It is a low grade building with a dirt floor and minimal infrastructure. Being located next to a brothel makes redevelopment difficult. However, a use has been identified as an off-campus centre and work is to proceed in May.
Vacant land, 24-26 Orr Street, Carlton valued at \$201 250.	Current use: Not specific This site was also purchased in accordance with the approved TAFE Master Plan and is required for proposed developments. The site formerly had squatters living in the derelict buildings, which were therefore demolished.
Kay House, 449 Swanston Street, Melbourne valued at \$6.4 million.	Current use: Commercial/Academic/Administrative As noted in the Report, some of this building is used by commercial tenants. The ground floor is best suited to commercial tenants and provides the University with an income to help offset the building's operational costs. The commercial tenants have previously occupied some minor spaces within the building not suited for general University uses, however, this landbank of spaces is currently being allocated to meet appropriate University needs as they arise.
Gateway House, 459 Swanston Street, Melbourne valued at \$1.8 million.	Current use: Commercial/University This building was originally purchased with the intent of demolishing it as part of a major development of the site. Use by commercial tenants is considered to be a practical way to provide a capital return in the interim.
Carpark and Newsagency, 435 Swanston Street, Melbourne valued at \$4.3 million.	Current use: Commercial/ Carpark This site was also purchased as a part of the Gateway building redevelopment. The current Capital Plan indicates that a significant development is proposed to commence during 1997 for which planning is well advanced.
410 Elizabeth Street, Melbourne valued at \$6.3 million.	Current use: Academic/Commercial The building was purchased with the understanding that the ground floor only (not the first floor as indicated in the Report notes) was leased. The lease expired on 21/3/95, the tenant is on overholding, however, the lease provides the University with income which helps offset the building operational costs.
Industrial Building 26 Cardigan Street, Carlton valued at \$403 000.	Current use: Commercial This building has only recently been purchased to enable the construction of the proposed new Health Sciences buildings (a submission has been presented to the OTFE requesting funds). The current building tenant lease expires this month. The University plans to make internal use of this building in the meantime.

While the Auditor-General's Report recognises that RMIT has undertaken a number of substantial initiatives to enhance the information available on its physical infrastructure, the Report fails to recognise a number of other initiatives undertaken by RMIT. These initiatives confirm RMIT's commitment to responsible management, and the improved performance, of its physical infrastructure base. Other initiatives include:

□ **RESPONSE** provided by Vice-Chancellor, Royal Melbourne Institute of Technology - continued

Introduction of property managers

Asset Management Group Property Manager created positions covering 6 zones (groups of buildings) across the University to interface with clients. This ensures a closer linkage with the building stock and services to the core business of the University and provides an appropriate avenue for rectification of problems, efficient provision of services, performance monitoring and improving customer satisfaction. A necessity in the competitive environment in which the University operates.

Service agreements

Service agreements between Asset Management Group and its clients specify the range and type services to be provided within timelines specified. Asset Management Group has separated those services which form part of the minimum service levels for buildings from those which can be offered on a pay-as-you-use basis. Asset Management Group will provide services as outline in these agreements and at the specified costs for pay as you use services.

Client service approach

Asset Management Group has adopted this approach to increase the level of service to clients, enhance the effectiveness and efficiency, improve satisfaction and underpin the strategic core business of the University.

Performance monitoring and measurement

Asset Management Group has implemented service agreements for the services they provide to customers within the University. In order to ensure the services specified are actually delivered, the implementation of a performance monitoring system for the services outlined within the service agreement is currently being introduced. All services provided by Asset Management Group will be monitored to ensure that contractors and staff are providing the services, specified in the service agreement to an acceptable standard and to demonstrate to customers that Asset Management Group is fulfilling the levels of service outlined within the service agreement and to identify and eliminate areas of inadequate performance, inefficiency, or wastage. A further reason for monitoring performance is because it is good management practice.

These initiatives place RMIT's management of its physical infrastructure at the leading edge of asset management within Australian universities. It is worth noting that the processes and procedures in place more than favourably compare with universities exhibiting best practice in the asset management area anywhere else in the world.



MANAGEMENT OF GRANTS IN RELATION TO ADULT, COMMUNITY AND FURTHER EDUCATION

3.1.65 The Adult, Community and Further Education Board was established by the *Adult Community and Further Education Act 1991* to provide “*Victorian adults with an opportunity to participate in life-long learning contributing to their social, cultural and economic development as individuals and members of the community*”. The Board’s major functions are to develop policies, allocate resources and advise the Minister on matters related to adult, community and further education.

3.1.66 Under the Act, the Board may provide funds for further education activities to “*any person, organisation or institution, whether public or private*”.

3.1.67 In this regard, the Board operates 9 regional councils which, consistent with performance agreements with the Board, distribute approximately \$25 million a year in grants to 560 service providers of adult, community and further education. A service provider is defined as “*... any organisation which has objects consistent with the Act, is managed by and responsive to the community which it serves, has a major focus on meeting the educational needs of Victorian adults, and is not for profit*”. Generally, service providers are TAFE colleges, neighbourhood houses and other educational co-operatives.

3.1.68 Each regional council consists of 12 members appointed by the Minister with at least one-half of council members having substantial and current experience in the provision of adult, community and further education. Council members do not receive payment for their services but are reimbursed for costs incurred.

3.1.69 Each council is supported by a regional director and other administrative staff who have responsibility for developing plans to promote, support, resource and evaluate adult education programs within their region. They also contribute to Statewide planning and policy development.

3.1.70 The Board’s allocation of grants to regional councils is based on a Statewide funding model, which requires the Board to establish annual percentages for the 3 components upon which the allocations are based, namely:

- equality of access;
- development of adult education in the community; and
- special circumstances, as determined by the Board.

3.1.71 These percentages are determined by the Board after considering related government policies, strategic and annual plans, and the training profile needs established by the State Training Board for Victoria.

Funding framework

3.1.72 The Adult, Community and Further Education Board has taken an active role in the past year to improve the administration of grants provided by regional councils through the release of numerous policy guidelines covering tendering for service providers, regional council operations, including funding, and performance monitoring and evaluation.

3.1.73 Even though these guidelines have mandatory status, it was found that there was only selective adherence and inconsistent application of these guidelines by regional councils.

3.1.74 In August 1996, a framework was introduced by the Board which changed the funding of service provision from one based on infrastructure and program delivery to the purchase of student contact hours and associated support for the development of adult education. Under this framework, the Board determines the average cost for a student contact hour, however, regional councils have some flexibility to vary this form of allocation depending upon the cost of different programs or other factors such as rural isolation.

3.1.75 The regional councils allocate funds to service providers following consideration of submissions and tenders from perspective providers, consistent with parameters established as part of the annual performance agreement between each regional council and the Board. In July 1996, the Board decided that a minimum of 25 per cent of regional council allocations were to be subject to competitive tenders between service providers, with the balance allocated on the basis of provider submissions.

3.1.76 While regional council staff provided audit with adequate verbal explanations for the allocation of funding to service providers generally, there was a lack of formal documentation of the evaluation of submissions and tenders, including the application of standard criteria.

3.1.77 Following regional councils' ratification of funding allocations, service providers are required to enter into performance agreements with the councils. These agreements, which are required to be signed by the service providers prior to payment of grant funds, specify the terms and conditions of the funding and outline the performance targets on which the service provider will be assessed.

3.1.78 The audit found, for the 1996 year, that the majority of grants were issued to service providers prior to the finalisation of the agreements. However, for the 1997 year, regional councils have adopted the practice of not making payments until the performance agreements have been finalised.

3.1.79 To ensure that funding allocations are soundly based and equitable, the Board needs to develop standard criteria to be used in assessing service providers' submissions and tenders, and require the formal documentation of evaluations.

Performance monitoring

3.1.80 Service providers are required to forward data on student contact hours to the Board via regional councils to assist in evaluating the performance of the providers and regional councils.

3.1.81 Audit found significant time lags at regional councils in evaluating service provider performance. In particular, information relating to 1996 actual student contact hours, which is a key performance evaluation criteria, was not processed by councils until April 1997. Nevertheless, regional councils entered into the 1997 funding agreements with service providers nearly 6 months before the previous year's performance was evaluated. Although regional councils may adjust current year grants if the prior year targets have not been achieved, there remains a risk that under-performing providers could be re-appointed.

3.1.82 **The Board plan to seek half yearly data in 1997 with the objective of receiving up-to-date information from which decisions in relation to service providers can be made. But due to the short duration of some courses, consideration should be given to obtaining more regular data.**

Financial reporting by service providers

3.1.83 The Department of Treasury and Finance guidelines for funding of non-government organisations specify the minimum financial accountability requirements. These guidelines require organisations to provide the responsible government agencies with accountability statements attesting that funds received have been spent in accordance with the established funding agreements.

3.1.84 However, audit found that in relation to the management of grants in respect of adult, community and further education provided to service providers:

- 50 per cent of regional councils reviewed by audit did not follow-up outstanding financial accountability statements from service providers;
- the majority of financial accountability statements submitted by service providers were not independently audited as required; and
- regional councils made little or no use of the financial information submitted by providers.

3.1.85 **As a consequence, assurance was generally not obtained from service providers that grants had been appropriately expended in accordance with the performance agreements.**

Grants management system

3.1.86 A computerised grants management system was developed by the Board in 1993 to improve management reporting by regional councils and the Board. However, this system was not fully implemented across all councils due to design and system difficulties.

3.1.87 In late 1996, the Board appointed consultants to re-engineer the system, with the objective of integrating and streamlining all associated processes, including those relating to grant payments and administration, and key performance data. It is anticipated that this project will be completed by September 1997 at an estimated cost of \$300 000 not including any additional hardware costs which may be required.

Corporate governance

3.1.88 At all times, members of regional councils need to act in the interests of the community. In this regard, the Act and the Board's guidelines require members to disclose to their regional council any conflicts of interest.

3.1.89 Given the membership requirements of councils, as previously outlined in this Report, it is inevitable that issues of conflicts of interest will arise. However, members should not take part in any decision-making process which will result in such a conflict.

3.1.90 The audit review found a number of instances where council members did not disclose conflicts of interest in relation to resolutions that affected service providers with which they were directly connected. Audit also observed that pecuniary interest registers, at a number of regional councils, were not kept up-to-date.

3.1.91 In addition, certain conflicts of interest were identified arising from committee members, who were associated with service providers, having access to other service provider tenders which could impact on the equity associated with future tender processes.

3.1.92 **To ensure the probity over regional council operations, there is a need to reinforce members' responsibilities relating to issues of actual or potential conflicts of interest.**

Utilisation of closed primary and secondary schools

3.1.93 Since March 1996, 18 previously closed primary and secondary schools have been used by the providers free of charge which was in contrast with the Board's strategic plan which identified among its key directions:

- resource management that is transparent, accountable and fair; and
- competition while encouraging autonomous providers within the system.

3.1.94 **The current practice of allowing these properties to be used free of charge gives the tenants an unfair advantage compared with other service providers.**

3.1.95 While the Boards funding framework provides regional councils with the option to vary the level of funding given to the service providers if the "*provider operates from premises owned by government and leased for a minimal amount*", there was no evidence that this option was exercised in relation to regional councils visited by audit.

□ **RESPONSE** provided by Chairperson, Adult, Community and Further Education Board

Funding framework

The Board introduced its new Regional Funding Framework in 1996 and recognising that 1996 was a transition year allowed partial implementation of some aspects of the policy. In 1997 the Board's internal audit program focuses on Regional Council adherence to Board policies and guidelines. The Board also intends, in the 1997 annual performance agreement negotiation process with Regional Councils, to review their progress in implementing new policies and guidelines and the specific recommendations made in internal audit reports.

The Board is working further with Regional Councils on providing them with the necessary administrative techniques to support application of the Regional Funding Framework. A best practice approach will be developed on formal documentation of evaluation.

In respect to funding allocations, equitable and transparent funding processes are underpinning principles of the Board's policy approach. The need for standardised centrally determined criteria must, however, be balanced against the need for regional flexibility, so that the ACFE program continues to meet the educational requirements of diverse local communities.

Performance monitoring

The Board recognises that there is an inherent time lag between the funding of providers and the collection of student completions data from the previous year. To improve accountability, the Board will examine the capacity of its new grants management system to include a progress report from providers, which confirms initial enrolments, before triggering their second payment.

Financial reporting by service providers

The Board note the comments and will follow them up through the 1997 internal audit program which will check Regional Councils' adherence to requirements for receipt and follow-up of financial statements. Professional development will be provided for Regional Council Directors on monitoring of provider expenditure in accordance with funding agreements before the Board enters into next round of Regional Council performance agreement negotiations.

Corporate governance

In 1996, the Board issued Good Practice for Regional Councils. Conflict of interest received extensive attention in section 9 of the document. The Board, with Regional Councils, intends to develop a more comprehensive manual of best practice for Regional Councils in 1997, and support its implementation with a program of professional development for Regional Councillors. The comments on pecuniary interest and management of conflict of interest will be included. In addition, the internal auditor will be checking that pecuniary registers are maintained and up-to-date. In future, the initial letter of appointment of Regional Councillors will also note that they are required to complete a declaration of pecuniary interest.

□ **RESPONSE** provided by Chairperson, Adult, Community and Further Education Board - *continued*

Utilisation of closed primary and secondary schools

The practice of allowing the properties to be used free of charge is noted, and the Board will request the Department of Education to consider these comments in preparation of contracts with providers.

LOSSES, THEFTS AND IRREGULARITIES

3.1.96 Table 3.1G summarises particulars of losses, thefts and irregularities, including property damage, which occurred in 1996, and which were reported to audit by entities within the Education sector.

TABLE 3.1G
LOSSES, THEFTS AND OTHER IRREGULARITIES
 (\$)

<i>Item</i>	<i>Amount</i>
Department of Education -	
Funds	7 720
Equipment and property damage	1 928 794
Technical and Further Education Institutes -	
Funds	5 302
Equipment and property damage	159 730
Universities -	
Funds	119 672
Equipment and property damage	413 125

3.1.97 Major incidences of losses and thefts of funds and equipment, and property damage are detailed below:

- A number of fires at schools were reported by the Department of Education. The suspected cause was arson and police were notified. The major fires reported and estimated damages were Gladstone Park Secondary College (\$170 000) and Noble Park Primary School (\$50 000);
- Computers and other school equipment to the value of \$40 000 were stolen from the Leongatha Secondary College;
- An employee stole student fees totalling \$64 810 from Monash University. Police were notified and the employee was prosecuted;
- La Trobe University reported a theft of \$35 000 of computer and scientific equipment from the physics department at its Bundoora campus; and
- An internal audit of a department within the University of Melbourne detected mis-appropriation of cash in excess of \$51 000 over a 3 year period.

**SCHEDULE A
 STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

DEPARTMENT OF EDUCATION

<i>Ministerial Portfolios, May 1996, p.27.</i>	The Department needs to interrogate the current database to identify assets that have incorrect values and implement edit procedures that will, in the future, provide quality assurance over the input of data at schools.	The database has been interrogated and assets with excessive valuation were corrected following verification with schools.
<i>Ministerial Portfolios, May 1996, p.27.</i>	The Department needs to reinforce to all schools that regular stocktakes need to be undertaken in order to identify missing or surplus assets.	The Department distributed advice to all schools which addressed the issue of stocktaking.

UNIVERSITY OF MELBOURNE

<i>Ministerial Portfolios, May 1996, pp.52-3.</i>	The University should implement an internal user charging system to act as an incentive to ensure the economical use of existing properties and to assess requests for additional space.	Investigation of options for charging the users of buildings for the space they occupy is in progress and, if a clear benefit against the costs involved can be established, a scheme may be introduced in 1998.
<i>Ministerial Portfolios, May 1996, pp.47-8.</i>	The existing uneven pattern of use of the University's 66 lecture theatres, including low utilisation during early morning and mid to late afternoon on weekdays and in particular on Fridays, creates an artificial need for a larger stock of lecture theatres than would otherwise be the case. Limited lecture theatre usage outside the teaching day was also identified by audit.	New procedures for the allocation of lecture theatres are being developed. A set of principles have been accepted by the Academic Board which will simplify to some degree the allocation process and new software has been purchased to implement these principles. It is expected that by the second half of 1997, the computer-aided lecture theatre allocation process will be in operation.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued

Report	Subject	Status at date of preparation of this Report
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NO ACTION

UNIVERSITY OF MELBOURNE

<p><i>Ministerial Portfolios, May 1996, pp.33-47.</i></p>	<p>Lengthy delays have occurred in the determination of an appropriate academic or research-related use for some property acquisitions. Audit identified substantial properties which had been under-utilised or inappropriately utilised for lengthy periods. The University should place greater emphasis on rationalising and consolidating its existing stock of property assets and reduce its focus on the expansion of its property portfolio.</p>	<p>The University considers that property utilisation has been appropriate in the light of the various development plans which were and are under consideration. In particular, to have made the capital investment necessary to allow most of the properties to be used or let, would have resulted in significant loss.</p>
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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

Entity	Financial year ended	Reporting to Parliament	Financial statements signed by entity	Auditor-General's report signed
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COMPLETED AUDITS

Department of Education	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	26 Sept. 1996	27 Sept. 1996
EDUCATION				
Board of Studies	30 June 1996	" "	5 Sept. 1996	10 Sept. 1996
Telematics Course Development Fund Trust	31 Dec. 1995	30 April. <i>Financial Management Act 1994</i> , s.46.	28 Mar. 1996	25 June 1996
TERTIARY EDUCATION AND TRAINING				
Adult, Community and Further Education Board	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	30 Sept. 1996	4 Oct. 1996
Council of Adult Education	31 Dec. 1996	30 April. <i>Financial Management Act 1994</i> , s.46.	15 Mar. 1997	18 Mar. 1997
International Training Australia Pty Ltd	31 Dec. 1996	" "	2 May 1997	2 May 1997
State Training Board	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	16 Sept. 1996	26 Sept. 1996
Victorian Tertiary Admission Centre	30 June 1996	No reporting requirements.	20 Dec. 1996	24 Jan. 1997

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
Post-secondary education institutions				
<i>Universities and associated companies</i>				
Australian Music Examination Board (Vic.) Ltd	31 Dec. 1996	30 April. <i>Melbourne University Act 1958, s.41.</i>	12 Feb. 1997	13 Mar. 1997
Australian National Academy of Music Ltd	31 Dec. 1996	" "	25 Mar. 1997	27 Mar. 1997
Citytech Pty Ltd	31 Dec. 1996	30 April. <i>Royal Melbourne Institute of Technology Act 1992, s.39.</i>	27 Mar. 1997	8 April 1997
Deakin University	31 Dec. 1996	30 April. <i>Financial Management Act 1994, s.46.</i>	17 Mar. 1997	25 Mar. 1997
Deakin University Foundation Ltd	31 Dec. 1996	30 April. <i>Deakin University Act 1974, s.34A.</i>	7 Mar. 1997	14 Mar. 1997
Deakin University Foundation Trust	31 Dec. 1996	" "	7 Mar. 1997	14 Mar. 1997
Dova Port Pty Ltd	31 Dec. 1996	30 April <i>Latrobe University Act 1971, s.37A.</i>	10 April 1997	28 April 1997
Hawthorn Institute of Education Ltd	31 Dec. 1996	30 April <i>Financial Management Act 1994, s.46.</i>	25 Mar. 1997	26 Mar. 1997
Institute for Innovation and Enterprise Ltd	31 Dec. 1996	30 April <i>Swinburne University of Technology Act 1992, s.44.</i>	14 Mar. 1997	20 Mar. 1997
La Trobe International Pty Ltd (a)	31 Dec. 1996	30 April <i>Latrobe University Act 1964, s.37A</i>	27 Feb. 1997	27 Feb. 1997
La Trobe Marketing Pty Ltd	31 Dec. 1996	" "	6 Feb. 1997	11 Feb. 1997
La Trobe University	31 Dec. 1996	30 April <i>Financial Management Act 1994, s.46.</i>	4 April 1997	29 April 1997
La Trobe University Housing Ltd	31 Dec. 1996	30 April <i>Latrobe University Act 1964, s.37A.</i>	14 Feb. 1997	17 Feb. 1997
Melbourne Information Technologies Australia Pty Ltd	31 Dec. 1996	30 April <i>Melbourne University Act 1958, s.41.</i>	14 Mar. 1997	21 Mar. 1997
Meltech Services Pty Ltd	31 Dec. 1996	30 April <i>Royal Melbourne Institute of Technology Act 1992, s.39.</i>	15 Mar. 1997	18 Mar. 1997
Milake Pty Ltd	31 Dec. 1996	30 April <i>Deakin University Act 1974, s.34A.</i>	11 Mar. 1997	14 Mar. 1997

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
<i>Post-secondary education institutions - continued</i>				
<i>Universities and associated companies - continued</i>				
Monash - Mt Eliza Graduate School of Business and Government Ltd	31 Dec. 1996	30 April <i>Monash University Act 1958, s.35B.</i>	18 Feb. 1997	4 Mar. 1997
Monash International Pty Ltd	31 Dec. 1996	" "	20 Feb. 1997	25 Feb. 1997
Monash IVF Pathology Services Pty Ltd	31 Dec. 1996	" "	17 Jan. 1997	4 Mar. 1997
Monash IVF Pathology Services Trust	31 Dec. 1996	" "	17 Jan. 1997	4 Mar. 1997
Monash IVF Pty Ltd	31 Dec. 1996	" "	17 Jan. 1997	4 Mar. 1997
Monash Language Centre Pty. Ltd.	31 Dec. 1996	" "	24 Feb. 1997	26 Feb. 1997
Monash Merchandising Company Pty Ltd	31 Dec. 1996	" "	14 Feb. 1997	4 Mar. 1997
Monash Merchandising Unit Trust	31 Dec. 1996	30 April <i>Monash University Act 1958, s.35B.</i>	14 Feb. 1997	4 Mar. 1997
Monash University	31 Dec. 1996	30 April <i>Financial Management Act 1994, s.46.</i>	10 Mar. 1997	17 Mar. 1997
Monash Ultrasound Pty Ltd	31 Dec. 1996	30 April <i>Monash University Act 1958, s.35B.</i>	17 Jan. 1997	4 Mar. 1997
Monash Ultrasound Trust	31 Dec. 1996	" "	17 Jan. 1997	4 Mar. 1997
Monash University Foundation Pty Ltd	31 Dec. 1996	" "	10 Mar. 1997	12 Mar. 1997
Monash University Foundation Trust	31 Dec. 1996	" "	10 Mar. 1997	12 Mar. 1997
Montech Medical Development Pty Ltd	31 Dec. 1996	" "	5 Feb. 1997	4 Mar. 1997
Montech Pty Ltd	31 Dec. 1996	" "	5 Feb. 1997	4 Mar. 1997
Neurometric Systems Pty Ltd	31 Dec. 1996	30 April <i>Swinburne University of Technology Act 1992, s.44.</i>	14 Mar. 1997	20 Mar. 1997
Opening Learning Agency of Australia Pty Ltd	31 Dec. 1996	30 April <i>Monash University Act 1958, s.35B.</i>	7 Mar. 1997	17 Mar. 1997

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
<i>Post-secondary education institutions - continued</i>				
<i>Universities and associated companies - continued</i>				
RMIT	31 Dec. 1996	30 April <i>Financial Management Act 1994,</i> s.46.	25 Mar. 1997	30 April 1997
RMIT Foundation	31 Dec. 1996	30 April <i>Royal Melbourne Institute of Technology Act</i> 1992, s.39.	8 April 1997	15 April 1997
RMIT Innovation Ltd	31 Dec. 1996	" "	25 Mar. 1997	29 April 1997
RMIT International Pty Ltd	31 Dec. 1996	" "	25 Mar. 1997	21 April 1997
RMIT Malaysia	31 Dec. 1996	" "	25 Mar. 1997	29 April 1997
RMIT Resources Limited (b)	31 Dec. 1996	" "	25 Mar. 1997	21 April 1997
RMIT Training Pty Ltd	31 Dec. 1996	" "	25 Mar. 1997	15 April 1997
RMIT Union	31 Dec. 1996	30 April <i>Royal Melbourne Institute of Technology Act</i> 1992, s.39.	17 Mar. 1997	21 Mar. 1997
School of Forestry Creswick Ltd	31 Dec. 1996	30 April <i>Melbourne University Act 1958,</i> s.41.	6 Feb. 1997	11 Feb. 1997
Sir John Monash Business Centre Pty Ltd	31 Dec. 1996	30 April <i>Monash University Act 1958,</i> s.35B.	5 Feb. 1997	25 Feb. 1997
Swinburne Ltd	31 Dec. 1996	30 April <i>Swinburne University of Technology Act 1992,</i> s.45.	14 Mar. 1997	25 Mar. 1997
Swinburne University of Technology	31 Dec. 1996	30 April <i>Financial Management Act 1994,</i> s.46.	14 Mar. 1997	25 Mar. 1997
Unilink	31 Dec. 1996	30 April <i>Deakin University Act 1974,</i> s.34A.	10 Mar. 1997	14 Mar. 1997
Unimelb Ltd	31 Dec. 1996	30 April <i>Melbourne University Act 1958,</i> s.41.	14 Mar. 1997	21 Mar. 1997
University of Ballarat	31 Dec. 1996	30 April <i>Financial Management Act 1994,</i> s.46.	26 Mar. 1997	27 Mar. 1997
University of Melbourne	31 Dec. 1996	" "	11 April 1997	29 April 1997

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
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COMPLETED AUDITS - continued

Post-secondary education institutions - continued

Universities and associated companies - continued

Victoria University Enterprises Proprietary Limited (c)	31 Dec. 1996	30 April <i>Victoria University of Technology Act 1990, s.42.</i>	11 Mar. 1997	7 April 1997
Victoria University of Technology	31 Dec. 1996	30 April <i>Financial Management Act 1994, s.46.</i>	24 Mar. 1997	7 April 1997
Victoria University of Technology Foundation Ltd	31 Dec. 1996	30 April <i>Victoria University of Technology Act 1990, s.42.</i>	11 Mar. 1997	7 April 1997
Victorian College of Agriculture and Horticulture Ltd	31 Dec. 1996	30 April <i>Financial Management Act 1994, s.46.</i>	4 Mar. 1997	13 Mar. 1997
Victorian College of the Arts	31 Dec. 1996	" "	27 Mar. 1997	2 April 1997

Institutes/Colleges of Technical and Further Education

Barton	31 Dec. 1996	30 April <i>Financial Management Act 1994, s.46.</i>	24 Feb. 1997	20 Mar. 1997
Bendigo Regional	31 Dec. 1996	" "	14 Mar. 1997	20 Mar. 1997
Box Hill	31 Dec. 1996	" "	27 Feb. 1997	18 Mar. 1997
Casey	31 Dec. 1996	" "	21 Mar. 1997	21 Mar. 1997
Central Gippsland	31 Dec. 1996	" "	5 Mar. 1997	26 Mar. 1997
Driver Education Centre of Australia Ltd	31 Dec. 1996	30 April <i>Financial Management Act 1994, s.53A.</i>	18 Mar. 1997	20 Mar. 1997
East Gippsland	31 Dec. 1996	30 April <i>Financial Management Act 1994, s.46.</i>	15 Mar. 1997	21 Mar. 1997
Gordon Institute	31 Dec. 1996	" "	12 Mar. 1997	13 Mar. 1997
Goulburn Ovens (d)	31 Dec. 1996	" "	26 Mar. 1997	26 Mar. 1997
Holmesglen	31 Dec. 1996	" "	14 Mar. 1997	18 Mar. 1997
John Batman	31 Dec. 1996	" "	18 Mar. 1997	21 Mar. 1997

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
<i>Institutes/Colleges of Technical and Further Education - continued</i>				
Kangan	31 Dec. 1996	30 April <i>Financial Management Act 1994, s.46.</i>	17 Mar. 1997	18 Mar. 1997
Melbourne College of Textiles	31 Dec. 1996	" "	24 Mar. 1997	24 Mar. 1997
Northern Melbourne	31 Dec. 1996	" "	26 Feb. 1997	7 Mar. 1997
Outer Eastern	31 Dec. 1996	" "	13 Mar. 1997	20 Mar. 1997
Peninsula Institute	31 Dec. 1996	" "	10 Feb. 1997	14 Mar. 1997
School of Mines and Industries Ballarat Ltd	31 Dec. 1996	" "	19 Feb. 1997	20 Feb. 1997
South West	31 Dec. 1996	" "	28 Feb. 1997	13 Mar. 1997
Sunraysia	31 Dec. 1996	" "	27 Mar. 1997	27 Mar. 1997
Western Melbourne	31 Dec. 1996	" "	11 Mar. 1997	18 Mar. 1997
William Angliss	31 Dec. 1996	" "	9 April 1997	15 April 1997
Wimmera	31 Dec. 1996	" "	13 Mar. 1997	18 Mar. 1997
Wodonga	31 Dec. 1996	" "	11 Mar. 1997	14 Mar. 1997

INCOMPLETE AUDITS

EDUCATION

Telematics Course Development Fund Trust	31 Dec. 1996	31 April. <i>Financial Management Act 1994, s.46.</i>	Audit substantially completed.
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(a) La Trobe International Pty Ltd was previously known as Mycell International Pty Ltd.

(b) RMIT Resources Limited was previously known as RMIT Limited.

(c) Victoria University Enterprises Proprietary Limited was previously known as Western Melbourne Business Developments Pty Ltd.

(d) Goulburn Ovens Institute of TAFE is a new Institute resulting from the merger of Goulburn Valley and Wangaratta Institutes of TAFE.

Part 3.2

Human Services

KEY FINDINGS

Private practice arrangements

- While acknowledging that significant improvement had been made in the accountability arrangements for full-time medical officers participating in private practice activities in public hospitals, it was evident that problems persisted in relation to a number of long-standing arrangements. *Paras 3.2.12 to 3.2.15*
- Due mainly to the reduction in the proportion of patients treated in public hospitals who are privately insured, there has been a significant decline in the level of funds that hospitals generate from private practice activities. *Paras 3.2.8 to 3.2.10*
- Hospitals need to develop strategies to deal with the decrease in revenue from private practice activities in order to avert adverse impacts on other hospital activities. *Para 3.2.11*
- Despite assurances provided by the Department of Human Services in 1991, neither the hospital industry nor the Department had evaluated the adequacy of the facility charges imposed on medical staff for use of hospital facilities for private practice purposes. *Paras 3.2.18 to 3.2.20*

Delays in finalising health service agreements

- It was surprising to find that the unsatisfactory position brought to the attention of Parliament in 1992 regarding delays in finalising health service agreements has in fact deteriorated some 5 years later. *Paras 3.2.29 to 3.2.31*
- Substantial delays occurred in the finalisation of health service agreements for both the 1995-96 and 1996-97 financial years. *Paras 3.2.32 to 3.2.39*
- It is of concern that, in the event of a dispute arising between the Department and a hospital regarding funding, penalties and bonuses, the absence of a formal health service agreement detailing the rights, obligations and liabilities of the respective parties could result in either party suffering financial loss. *Paras 3.2.40 to 3.2.43*
- The Department has recently recognised the need to streamline the health service agreement process. *Para. 3.2.44*

3.2.1 The Minister for Health and Aged Care, the Minister for Youth and Community Services, the Minister for Housing and the Minister responsible for Aboriginal Affairs, have responsibility for operations within the Human Services sector. These Ministers have collective responsibility for the Department of Human Services.

3.2.2 Details of the specific ministerial responsibilities for public bodies within the Human Services sector are listed in Table 3.2A. In addition to the Department of Human Services, the entities listed below were subject to audit by the Auditor-General during the 1995-96 financial year.

**TABLE 3.2A
MINISTERIAL RESPONSIBILITIES FOR PUBLIC BODIES
WITHIN THE HUMAN SERVICES SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Aboriginal Affairs	-
Aged Care	-
Youth and Community Services	-
Health	Advanced Dental Technicians Qualifications Board Ambulance Officers' Training Centre Alexandra and District Ambulance Service Ambulance Service Victoria - Metropolitan Region North Eastern Region North Western Region South Eastern Region South Western Region Western Region Anti-Cancer Council of Victoria Chiropractors Registration Board Chiropractors and Osteopaths Registration Board Dental Board of Victoria Dental Technicians Licensing Committee Health Computing Service Victoria Ltd Infertility Treatment Authority Medical Practitioners Board of Victoria Mental Health Review Board Nurses Board of Victoria Optometrists Registration Board Pharmacy Board of Victoria Physiotherapists Registration Board Prince Henry's Institute of Medical Research Psychologists Registration Board of Victoria Psychosurgery Review Board of Victoria Public hospitals and nursing homes (103) Trustees of the Anderson's Creek Cemetery Trust Trustees of the Ballarat General Cemetery and Crematorium Trustees of the Bendigo Cemeteries Trust Trustees of the Cheltenham Cemeteries Trust Trustees of the Fawkner Crematorium and Memorial Park Trustees of the Geelong Cemeteries Trust Trustees of the Keilor Cemetery Trust Trustees of the Lilydale Memorial Park and Cemetery Trustees of the Memorial Park Altona

TABLE 3.2A
MINISTERIAL RESPONSIBILITIES FOR PUBLIC BODIES
WITHIN THE HUMAN SERVICES SECTOR - continued

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Health - continued	Trustees of the Mildura Cemetery Trust Trustees of the Necropolis Springvale Trustees of the Preston Cemetery Trust Trustees of the Templestowe Cemetery Trust Trustees of the Werribee Cemetery Trust Victorian Health Promotion Foundation
Housing	-

3.2.3 Comment on matters of significance arising from the audit of entities within the Human Services sector is provided below.

PRIVATE PRACTICE ARRANGEMENTS - FOLLOW-UP

3.2.4 For many years, full-time medical practitioners employed by public hospitals have been granted the right to earn additional income by providing medical services to private patients in public hospitals. In the 1995-96 financial year, income of around \$45 million was generated by 450 full-time medical officers under these arrangements with the moneys allocated between the doctor and the hospital according to an agreed percentage.

3.2.5 The sanctioning of private practice arrangements in public hospitals assists these agencies to recruit and retain high-calibre medical staff. The funds generated by these private practice arrangements also provides the means to pay medical practitioners bonuses and other benefits which include payment of professional subscriptions and medical indemnity insurance. In addition, the costs of text books, professional journals and travel for professional purposes within Australia and overseas can also be funded under the arrangements.

3.2.6 The Auditor-General's *Ministerial Portfolios Report, April 1991*, contained an article on private practice arrangements involving full-time medical practitioners which outlined a number of serious deficiencies in the control and accountability exercised by public hospitals over these arrangements. In particular, the Report identified that:

- there were poor management controls over these arrangements and therefore hospitals could not ensure that all amounts due under the arrangements were received;
- facility fees had not been costed or evaluated for many years, which may have resulted in Victorian taxpayers subsidising certain private practice arrangements; and
- there was uncertainty as to the obligations of hospital board members regarding taxation matters relating to private practice funds.

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3.2.7 For the 1995-96 financial year, the audit opinion issued on the financial statements of a major metropolitan healthcare network was qualified on the basis that there was no formal agreement or financial information available at the network to enable audit verification of amounts due under the private practice arrangements. Given the continuing concern relating to these arrangements, an audit review was undertaken to assess the extent of action taken by public hospitals to enhance accountability and financial control over their operation, particularly at large public hospitals.

Changing public hospital environment

3.2.8 Over the past 6 years, there have been a number of factors that have impacted on private practice activities at public hospitals. In particular, while private practice activities have mainly centred around radiology, pathology, anaesthetics, paediatrics and certain clinical services, in recent years there has been substantial privatisation of radiology and pathology services, particularly at medium-sized metropolitan and large regional public hospitals. As a result, a number of unsatisfactory private practice arrangements identified by audit in the previous review have been wound-up.

3.2.9 Award salary rates for full-time medical officers have not substantially changed over the past 5 years and, as a result, Victoria's public hospitals have found it increasingly difficult to match the benefits offered interstate and in the private sector when competing for the services of high-calibre medical staff. In order to address this situation, hospitals have offered private practice rights to the majority of full-time medical officers. Previously, these arrangements were only available to around 70 per cent of eligible full-time medical staff. In addition, a number of large hospitals have increased the bonus available to medical officers from 25 per cent to 40 per cent of normal salary entitlements.

3.2.10 While the overall remuneration levels of medical officers have increased, there has been a significant decline in the level of funds that are generated from private practice activities. This decline is mainly due to a reduction, from 28 per cent in 1990 to around 16 per cent in 1996, in the proportion of patients treated in public hospitals who are privately insured. As a result, hospitals increasingly need to pay bonuses to medical officers from other funding sources, as the funds generated from private practice activities are insufficient to support the guaranteed level of bonus.

3.2.11 Hospitals need to develop strategies to deal with the decrease in revenue available from private practice activities in order to avert adverse impacts on other hospital activities.

Accountability for private practice arrangements

3.2.12 The previous audit review found that accountability for private practice arrangements was deficient in most hospitals due, *inter alia*, to inadequate financial records, poor management controls, deficiencies in billing procedures, inadequate agreements with participating medical practitioners, and hospitals not having access to records maintained by private practice trusts.



3.2.13 The recent audit review of these issues found that steps had generally been taken by many hospitals to improve accountability and controls over these arrangements, including:

- implementation of systems and procedures by hospitals to ensure that all medical services rendered to private patients were appropriately classified and billed in a timely manner;
- enhancement by hospitals to controls and administration of private practice funds and special purpose accounts;
- improvements in the specification and formalisation of rules and procedures relating to expenditures reimbursed from the private practice funds; and
- establishment of legal agreements with medical practitioners covering employment obligations and entitlements to private practice.

3.2.14 While acknowledging that significant improvements had been made in the accountability arrangements for private practice activities, it was evident that problems persisted in relation to a number of long-standing arrangements. Specifically, there were instances of private practice arrangements that:

- had not been formally documented;
- allowed doctors to raise accounts and directly receive all remittances without hospitals having any legal right of access to patient or accounting records with these private practice arrangements generally not independently audited or related financial statements forwarded to hospitals; and
- were documented but the documentation did not specify control and administration procedures over the arrangements, with hospitals not able to enforce accountability requirements or ensure that the interests of the hospital were protected.

3.2.15 Where outdated private practice arrangements still exist, hospitals need to make a concerted effort to formalise the arrangements and ensure adequate measures of accountability and control are implemented. Furthermore, where hospitals are not involved in the billing or expenditure processes, audited financial statements covering the arrangements should be forwarded to hospitals as a condition of any agreement to permit private practice arrangements to continue.

Legal and taxation matters

3.2.16 The previous audit review indicated that the operation of private practice trust funds as separate legal entities not subject to hospital influence gave rise to concerns as to the taxation obligations of hospital board members as trustees, and the hospitals as group employers in relation to income earned by medical officers from the treatment of private patients.

3.2.17 Much of the uncertainty over taxation matters has been removed with many larger hospitals taking steps to clarify with the Australian Taxation Office taxation obligations relating to disbursements from private practice funds.

Recoupment of facility costs

3.2.18 Under existing guidelines, the first call on the income of each private practice fund is the recoupment of hospital expenses incurred as a consequence of the participating doctors engaging in private practice. The facilities charges, which range from between 20 per cent to 80 per cent of gross fees received, provide the means for reimbursing the hospitals for, among other things, the time lost when their full-time medical officers are engaged in private practice, and costs relating to the use of other hospital staff and equipment.

3.2.19 The previous audit review found that, due to inadequate costing procedures and deficient management information systems, most hospitals could not readily establish the costs incurred in making facilities available for private practice arrangements. In response, the Department of Human Services indicated that it would review the proportions of recoupment in consultation with the Victorian Hospitals Association and the Australian Medical Association. **Despite this undertaking, audit found that neither the Department nor the hospital industry had evaluated the adequacy of the facility charges imposed.**

3.2.20 **The facility charges need to be reviewed to ensure that they provide for an adequate recoupment of costs incurred by hospitals in relation to private practice arrangements, particularly to take account of the use of high cost medical equipment and the high levels of nursing and administration resources that are required in the provision of such services.**

□ *RESPONSE provided by Secretary, Department of Human Services*

The Department accepts and supports the findings.

The issue of cost recovery in the form of facilities charges was one which the Department had agreed to consider, in conjunction with the VHA and the AMA, in our response to your 1991 review.

The introduction of casemix funding and significant changes in the relationship between the Department and the hospitals rendered such central and uniform processes inappropriate. For this reason, the proposed review did not proceed.

Nevertheless, it is imperative that hospitals and networks pay attention to this issue on their own behalf.

DELAYS IN FINALISING HEALTH SERVICE AGREEMENTS

3.2.21 Health Service Agreements between the Department of Human Services and public hospitals were first established in 1986 and represent a contractual obligation for the level and range of services to be provided for an agreed quantum of funding. As such, the agreement process promotes an output orientated approach to hospital service delivery and funding across the Department's 5 programs which cover Acute Health; the Aged, Community and Mental Health; Youth and Family Services; Public Health; and Disability Services. This process replaced the former approach of allocating hospital funding by way of global budgets based on historical costs.



3.2.22 In my May 1992 *Report on Ministerial Portfolios*, I expressed disappointment that 14 of the State's 20 largest public hospitals finalised their 1990-91 agreements after 30 September 1990, with 5 agreements not finalised until December 1990. Such delays meant that some major hospitals only had 6 or 7 months to adjust activity levels to achieve the necessary outcomes, a situation that was not conducive to good hospital management or the efficient use of scarce public resources.

3.2.23 In August 1992 the former Economic and Budget Review Committee, in its review of the efficiency and effectiveness of Health Service Agreements, found that delays to finalising agreements were of real concern to hospitals in terms of the effect on cost, service quality and staff morale. The Committee also found that, as Health Service Agreements did not provide an explicit link between output and funding nor rewards for improving efficiency, incentives needed to be incorporated into agreements through the introduction of casemix funding for inpatient services.

3.2.24 The Committee suggested that the introduction of casemix funding into the agreement process would allocate funds to hospitals according to the number of patients and type of medical conditions treated.

3.2.25 In terms of the Department's Acute Health Program, the Government introduced casemix funding for all acute health services in public hospitals on 1 July 1993. The casemix funding system included the following objectives:

- to improve the efficiency of public hospitals;
- to provide for an expansion in the number of patients treated and allow a reduction in waiting lists;
- to introduce a fair basis for funding hospitals in the context of an overall budget reduction; and
- to encourage competition.

3.2.26 Casemix funding is based on an *arms-length* relationship between hospitals and the Department in line with the Government's purchaser/provider service delivery model and has been built into the health service agreement process. Under this arrangement, each hospital determines the extent of acute health services it can provide and negotiates the level of services to be delivered for each quarter with the Department which is the purchaser.

3.2.27 The casemix formula also allows public hospitals to compete for extra funds for additional throughput (\$91.6 million in 1996-97). The additional funding is allocated between competing service providers by the Department to ensure the achievement of policy objectives.

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3.2.28 In 1995 health care networks were formed to reshape the metropolitan health care system through the amalgamation of independent hospital boards into 6 Network Boards of Governance. Health care networks and public hospitals are accountable to the Department for the achievement of specified outputs detailed in Health Service Agreements, including the agreed additional throughput targets. The acute health budget for 1996-97 amounted to approximately \$2 billion. In 1996-97, approximately 85 per cent of outlays on health and community services, used to purchase services from external providers including non-government organisations, were subject to service agreements.

Current position

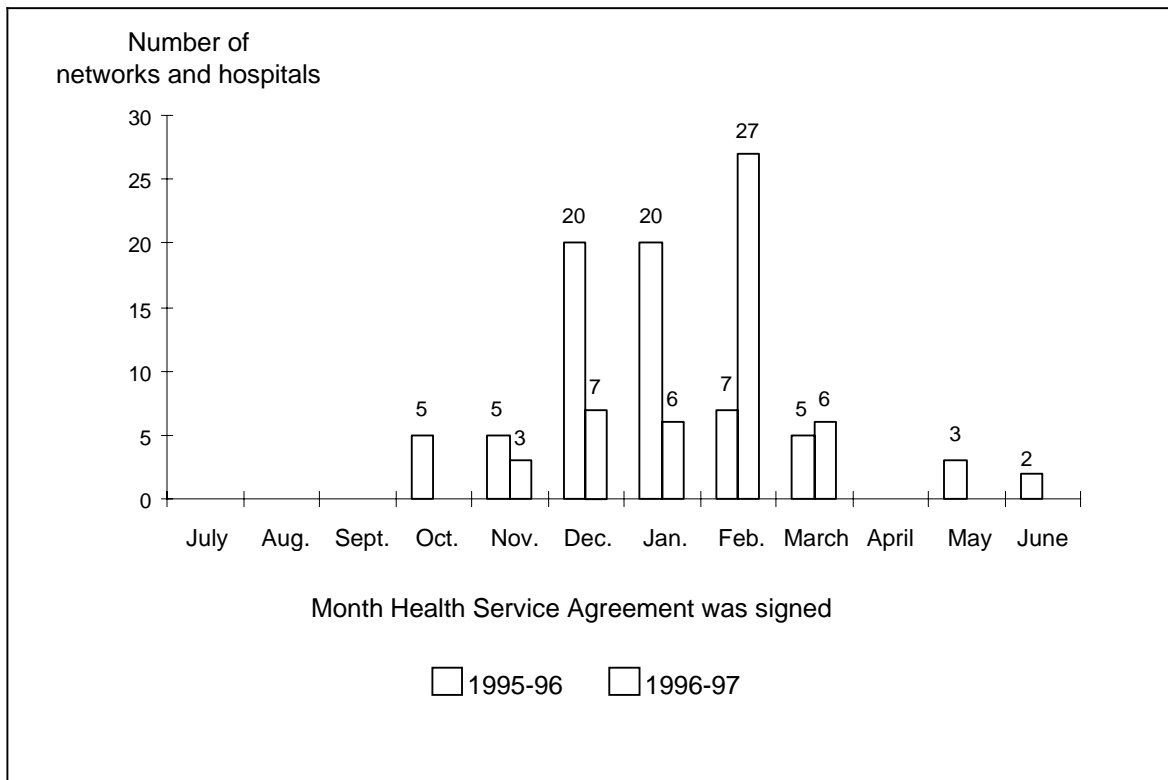
3.2.29 While my Office has recently commenced a major performance audit to assess whether certain aspects of acute health services funded under casemix have been effectively managed, I have decided to initially comment on the perennial issue of delays in the finalisation of Health Service Agreements between the Department of Human Services and public hospitals.

3.2.30 Audit was advised by the Department that the *Public Hospital Policy and Funding Guidelines* released in June, which is a separate document from the Health Service Agreements, is a key policy instrument used to fix prices, volumes and conditions for undertaking acute health work. The detailed information contained in the Guidelines provides the basis for the Department and hospitals to plan and undertake their respective purchasing and service provision roles. According to the Department, hospitals use this information to prepare their budgets for the year and the data for acute health services is included directly in Health Service Agreements.

3.2.31 Given this situation, **it was surprising to find that the unsatisfactory position brought to the attention of Parliament and the then Health Department Victoria in 1992 regarding delays in finalising Health Service Agreements has in fact deteriorated some 5 years later. This situation raises questions regarding the adequacy of the agreement process in its current form, especially in terms of the costs involved in administering the scheme.** If the majority of agreements continue to be formalised considerably later than the release of the policy and funding guidelines and after most of the year to which it relates has elapsed, the Department needs to assess whether the agreement process should be dramatically refined to avoid any unnecessary duplication and ensure that its funding arrangements with health care networks and public hospitals are finalised in the most cost-effective and efficient manner.

3.2.32 An audit survey covering a sample of 73 (89 per cent) health care networks and public hospitals shows that **substantial delays occurred in the finalisation of Health Service Agreements for both 1995-96 and 1996-97.** Chart 3.2B provides a comparison of the delays in which agreements were signed.

CHART 3.2B
DELAYS IN FINALISING HEALTH SERVICE AGREEMENTS BETWEEN
THE DEPARTMENT OF HUMAN SERVICES AND
HEALTH CARE NETWORKS/ACUTE PUBLIC HOSPITALS (a)



(a) Six health care networks represent 34 metropolitan hospitals including the major teaching and research hospitals.
 Note: Hospitals that became part of multi-purpose service centres (which do not operate under Health Service Agreements) or were amalgamated have been excluded from the above chart.
 Source: Information provided by health care networks and public hospitals in some cases involve estimates as Health Service Agreements are not required to be dated when signed.

3.2.33 With regard to Health Service Agreements for 1995-96, audit found that that agreements for the following hospitals had not been finalised or signed:

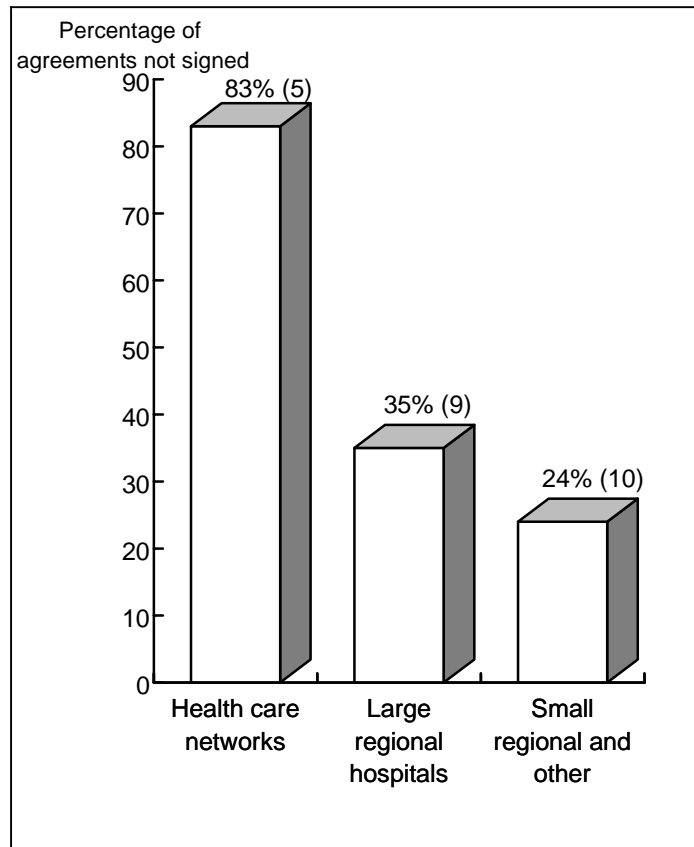
- Beechworth Hospital;
- Goulburn Valley Base Hospital;
- Skipton and District Memorial Hospital (ceased operation 30 September 1996);
- Wangaratta District Base Hospital; and
- Yea and District Memorial Hospital.

3.2.34 In addition, the 1995-96 agreement for the Eastern Health Care Network was not signed until early in 1996-97.

3.2.35 In terms of legislative requirements, the *Health Services Act* 1988 requires the Minister for Health to issue an *Interim Funding Statement* for the remainder of a financial year where an agency and the Department have failed to enter into a Health Service Agreement. Statements are to specify the nature, terms and conditions of the funding as well as the volume, scope and standard of services to be provided by the agency. The audit disclosed that in relation to 1995-96, *Interim Funding Statements* had not been issued in any of the above cases.

3.2.36 In relation to 1996-97, the audit disclosed that Health Service Agreements had not been signed for 24 or one-third of health care networks and public hospitals at 24 March 1997, details of which are shown in Chart 3.2C.

**CHART 3.2C
HEALTH SERVICE AGREEMENTS FOR 1996-97 NOT
SIGNED ACCORDING TO CATEGORY OF ACUTE
PUBLIC HOSPITALS**



Source: Information provided by health care networks and public hospitals in some cases involve estimates as Health Service Agreements are not required to be dated when signed.

3.2.37 Given that the acute health budget for 1996-97 for health care networks amounted to \$1.5 billion, it was disappointing to find that the only agreement to be signed with health care networks at 24 March 1997 was in relation to the Women’s and Children’s Health Care Network (covering a budget of \$160 million) which was signed in February 1997.

3.2.38 At the request of the Department, audit provided it with a breakdown on a hospital basis of the delays and those agreements that had not been finalised for 1996-97.



3.2.39 Discussions with senior officers within the Health portfolio suggested that the following factors may have contributed to the delays in 1995-96 and 1996-97:

- inadequate co-ordination of decision-making within the Department across the 5 programs (Acute Health; Aged, Community and Mental Health; Youth and Family Services; Public Health; and Disability Services) covered by each Health Service Agreement;
- the complexity of the health service agreement process which involves negotiation between a large number of parties;
- delays by Program Divisions of the Department in releasing essential details to departmental regions that were necessary for the completion of Health Service Agreements, such as funding allocations and service planning documentation;
- variations to hospitals' indicative budgetary targets (e.g. through changes to the casemix formula) made by the Department without prior consultation, resulting in further periods of negotiation; and
- the nature of the relationship developed through the health service agreement process provides a degree of leverage to hospitals in which to negotiate a position as the Department is often compelled to use each service provider.

Need for earlier finalisation of Agreements

3.2.40 The formal agreement of throughput targets and associated budgets in a timely manner are crucial to the efficient and effective implementation of any purchaser/provider arrangement so that service providers, in this particular case acute public hospitals, have sufficient time to confidently plan and implement operational strategies which meet agreed quarterly targets. The finalisation of Health Service Agreements in the early part of a financial year, ideally on 1 July, would also be beneficial in terms of enhancing accountability and enabling the Department to enforce its own policy of rewarding hospitals or applying sanctions to hospitals, such as the imposition of financial penalties if agreed targets are not met.

3.2.41 **It is of concern that, in the event of a dispute arising between the Department and a hospital regarding funding, penalties and bonuses, the absence of a formal agreement detailing the rights, obligations and liabilities of the respective parties could result in either party suffering financial loss.**

3.2.42 Audit is aware that the budget setting process undertaken by regional managers and hospital managements commences prior to the State Budget and hospitals are advised to set activity levels sustainable according to the likely budget outcome. It is also acknowledged that hospital managers may be aware of the likely budget scenario before agreement negotiations commence, which provides a degree of certainty in the decision-making process, and that delays in signing in some cases could involve disputes at the margins. Audit nevertheless maintains that the health service agreement process needs to be streamlined, and deadlines for signing agreements early in the financial year need to be established in order to:

- promote the finalisation of Health Service Agreements in an efficient manner;



- minimise unnecessary costs involved in the agreement progress; and
- enhance the accountability framework between public hospitals and the Department for the delivery of services specified and formally agreed to in Health Service Agreements.

3.2.43 An early finalisation of the negotiation process for the 1997-98 agreement year would obviously enhance the performance-orientated approach to the management of health service delivery and avoid the unsatisfactory situation that has occurred in the past. In audit opinion, the initiative of the Government to release 3 year forward estimates and the bringing down of the State Budget prior to the commencement of the financial year should assist in this process.

Current initiatives

3.2.44 The Department has recently recognised the need to streamline the health service agreement process. Advice was received from the Department that the following initiatives relate to the 1997-98 agreement process:

- to redevelop the current set of health service agreement documentation to produce a single integrated service purchasing and performance agreement framework;
- to introduce measures specific to the health service agreement process to improve co-ordination and communication across the Department at the program and regional level;
- to introduce technological solutions to facilitate and streamline the development of agency specific agreements;
- to promulgate agreement documentation and health service agreement process business rules prior to the commencement of the 1997-98 financial year; and
- to monitor the achievement of departmental contract management key performance indicators through its internal information system.

□ RESPONSE provided by Secretary, Department of Human Services

I accept that the level of signing of Health Service Agreements in the current financial year is disappointing.

Health Service Agreements between the Department of Human Services and hospitals or networks are composite agreements which encompass all departmentally-funded services provided by those hospitals/networks. Inclusion of all funding areas in one agreement was intended to streamline administrative processes and to reduce administrative cost at the agency level.

To date, we have needed agreement on each and every service area before signing could occur. Unfortunately the consequence of this approach has meant that disagreement about even some relatively small component of any one service area has the capacity to disrupt the whole process.

It is apparent that there have been a number of problems at both the program and regional level in terms of achieving sign-off of the composite Health Service Agreements for 1996-97.



□ **RESPONSE** provided by Secretary, Department of Human Services - continued

These problems should be seen in the context of a major restructure of the Department of Human Services following a review by McKinsey. This restructure has resulted in a new, integrated Aged, Community and Mental Health Division, the abolition of the former Primary Care Division and a strengthened Youth and Family Services Division. Regions have also been restructured. Roles of Regions in relation to contract management and administration have been substantially strengthened as a result of the restructure. Regions are responsible for purchasing all services, except for metropolitan regions in relation to Acute Health.

Restructure has also led to major review of purchasing frameworks and increased emphasis on output-based funding. Inevitably, during a period of transition, these changes have increased the level and difficulty associated with achieving sign-off of Health Service Agreements in the 1996-97 year. Nevertheless, this is an area of corporate priority and the Department will be placing the closest attention to these issues in relation to the 1997-98 year. In addition, the Department will this year introduce separate signing for each component of the Health Service Agreement so that disagreement in one area does not affect other program arrangements. A close monitoring arrangement will be put in place by the Corporate Services Division. Further, consultation has already commenced with Networks about 1997-98 Health Service Agreements in order to simplify and streamline the process and to enable early signing of Agreements.

LOSSES, THEFTS AND IRREGULARITIES

3.2.45 Table 3.2D summarises particulars of losses, thefts and other irregularities including property damage, which occurred during 1995-96 and which were reported to audit by the Department of Human Services and public bodies within the Human Services sector.

TABLE 3.2D
LOSSES, THEFTS AND OTHER IRREGULARITIES
(\$)

<i>Item</i>	<i>Amount</i>
Cash	19 775
Theft and damage to equipment and property	547 507

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SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

DEPARTMENT OF HUMAN SERVICES

<p><i>Ministerial Portfolios, May 1996, pp. 67-8.</i></p>	<p>The standard of record keeping by hospitals relating to payments to Visiting Medical Officers (VMOs) for fee-for-service arrangements was inconsistent and established control procedures over these payments were not always followed.</p>	<p>An Information Technology and Telecommunication Strategy for public hospitals has been developed and will be phased-in by hospitals over the next 5 to 8 years. While hospitals will retain autonomy in the acquisition of the information systems, the aim of the strategy is to improve clinical care and to provide costing and other performance monitoring information to facilitate decision making at both clinical and management levels.</p>
<p><i>Ministerial Portfolios, May 1996, pp. 68, 71-2.</i></p>	<p>Information systems did not enable managers to review individual VMO claim patterns as a means to detect potential over-servicing or to monitor performance of VMOs engaged under the new fractional appointment system.</p>	<p>Refer to the above comments.</p>
<p><i>Ministerial Portfolios, May 1996, p.69.</i></p>	<p>Savings may be available to medium-sized regional hospitals by moving away from uneconomic fee-for-service arrangements.</p>	<p>Renegotiated fee-for-service arrangements with VMOs have not achieved any significant savings for medium-sized regional hospitals.</p>
<p><i>Ministerial Portfolios, May 1996, p.72.</i></p>	<p>The Department should re-assess and clarify its responsibilities in ensuring a strong and consistent accountability framework in the public hospital system.</p>	<p>While health service agreements specify the level and type of services purchased from individual hospitals, as indicated earlier in this Report, delays have continued in the finalisation of the agreements.</p> <p>These agreements provide an accountability framework for public hospitals including performance indicators covering such things as waiting lists, access to emergency services and financial viability.</p>

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year/period ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS				
Department of Human Services	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	30 Sept. 1996	16 Oct. 1996
HEALTH				
Advanced Dental Technicians Qualifications Board	30 June 1996	" "	27 Sept. 1996	27 Sept. 1996
Ambulance Officers' Training Centre	30 June 1996	" "	26 Aug. 1996	29 Aug. 1996
Alexandra and District Ambulance Service	30 June 1996	" "	3 Oct. 1996	15 Oct. 1996
Ambulance Service Victoria -				
Metropolitan Region	30 June 1996	" "	30 Sept. 1996	1 Oct. 1996
North Eastern Region	30 June 1996	" "	4 Sept. 1996	29 Nov. 1996
North Western Region	30 June 1996	" "	22 Aug. 1996	18 Sept. 1996
South Eastern Region	30 June 1996	" "	30 Aug. 1996	27 Sept. 1996
South Western Region	30 June 1996	" "	21 Aug. 1996	28 Aug. 1996
Western Region	30 June 1996	" "	4 Sept. 1996	9 Sept. 1996
Anti-Cancer Council of Victoria	30 June 1996	" "	27 Sept. 1996	3 Oct. 1996
Anti-Cancer Council of Victoria	31 Dec. 1996	" "	27 Mar. 1997	15 April 1997
Chiropodists Registration Board of Victoria	31 Dec. 1996	" "	25 Mar. 1997	26 Mar. 1997
Chiropractors and Osteopaths Registration Board	31 Dec. 1996	" "	15 April 1997	30 April 1997
Dental Board of Victoria	30 Sept. 1996	" "	13 Nov. 1996	5 Dec. 1996
Dental Technicians Licensing Committee	30 June 1996	" "	27 Sept. 1996	27 Sept. 1996
Health Computing Service Victoria Ltd.	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	31 July. 1996	20 Aug. 1996
Infertility Treatment Authority	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	3 Feb. 1997	7 Feb. 1997

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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year/period ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
HEALTH - continued				
Medical Practitioners Board of Victoria	30 Sept. 1996	31 Oct. <i>Financial Management Act 1994, s.46.</i>	16 Jan. 1997	4 Feb. 1997
Mental Health Review Board	30 June 1996	" "	27 Sept. 1996	27 Sept. 1996
Nurses Board of Victoria	30 June 1996	" "	28 Aug. 1996	19 Sept. 1996
Optometrists Registration Board	30 June 1996	" "	16 Sept. 1996	20 Sept. 1996
Pharmacy Board of Victoria	30 June 1996	" "	26 Aug. 1996	26 Aug. 1996
Physiotherapists Registration Board	30 June 1996	" "	22 Aug. 1996	10 Sept. 1996
Prince Henry's Institute of Medical Research	31 Dec. 1996	" "	25 Mar. 1997	27 Mar. 1997
Psychologists Registration Board of Victoria	31 Dec. 1996	" "	29 April 1997	2 May 1997
Psychosurgery Review Board	30 June 1996	" "	25 Sept. 1996	27 Sept. 1996
Trustees of the Anderson's Creek Cemetery Trust	31 Dec. 1996	" "	20 Mar. 1997	25 Mar. 1997
Trustees of the Ballarat General Cemeteries and Crematorium	31 Dec. 1996	" "	21 Mar. 1997	9 April 1997
Trustees of the Bendigo Cemeteries Trust	31 Dec. 1996	" "	18 Mar. 1997	8 April 1997
Trustees of the Cheltenham Cemeteries Trust	31 Dec. 1996	" "	26 Mar. 1997	3 April 1997
Trustees of the Geelong Cemeteries Trust	31 Dec. 1996	" "	7 Mar. 1997	15 April 1997
Trustees of the Keilor Cemetery Trust	30 June 1995	" "	28 Mar. 1996	16 April 1996
Trustees of the Lilydale Memorial Park and Cemetery	31 Dec. 1996	" "	10 Feb. 1997	20 Feb. 1997
Trustees of the Memorial Park Altona	31 Dec. 1995	" "	29 Mar. 1996	11 Oct. 1996
Trustees of the Mildura Cemetery Trust	30 June. 1995	" "	18 Feb. 1997	24 Feb. 1997
Trustees of the Necropolis Springvale	31 Dec. 1996	" "	21 Mar. 1997	27 Mar. 1997

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year/period ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
HEALTH - continued				
Trustees of the Preston Cemetery Trust	30 June 1995	31 Oct. <i>Financial Management Act 1994</i> , s.46.	20 Mar. 1996	20 May 1996
Trustees of the Templestowe Cemetery Trust	31 Dec. 1996	" "	5 Mar. 1997	13 Mar. 1997
Trustees of the Werribee Cemetery Trust	30 June 1995	" "	30 April 1996	17 May 1996
Victorian Health Promotion Foundation	30 June 1996	" "	13 Sept. 1996	17 Sept. 1996
VICTORIAN PUBLIC HOSPITALS AND NURSING HOMES				
Alexandra District Hospital	30 June 1996	" "	14 Aug. 1996	11 Sept. 1996
Austin Hospital (b)	31 March 1995	" "	14 Mar. 1996	5 June 1996 (a)
Austin Repatriation Medical Centre (c)	30 June 1995	" "	14 Mar. 1996	5 June 1996 (a)
Bacchus Marsh and Melton Memorial Hospital	30 June 1996	" "	30 Sept. 1996	1 Oct. 1996
Bairnsdale Regional Health Service	30 June 1996	" "	10 Sept. 1996	11 Sept. 1996
Ballarat Base Hospital	30 June 1996	" "	28 Aug. 1996	19 Sept. 1996
The Beechworth Hospital	30 June 1996	" "	20 Sept. 1996	30 Sept. 1996 (a)
Benalla and District Memorial Hospital	30 June 1996	" "	9 Sept. 1996	19 Sept. 1996 (a)
Bendigo Health Care Group	30 June 1996	" "	31 Oct. 1996	31 Oct. 1996 (a)
Bethlehem Hospital Incorporated	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	18 Sept. 1996	23 Sept. 1996
Birregurra and District Community Hospital	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	25 Aug. 1996	24 Sept. 1996
Boort District Hospital	30 June 1996	" "	29 July. 1996	19 Aug. 1996
Bright District Hospital and Health Services	30 June 1996	" "	14 Aug. 1996	9 Sept. 1996

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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year/period ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
VICTORIAN PUBLIC HOSPITALS AND NURSING HOMES - continued				
Caritas Christi Hospice Limited	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	28 Sept. 1996	18 Nov. 1996
Casterton Memorial Hospital	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	17 Sept. 1996	17 Sept. 1996
Central Wellington Health Service	30 June 1996	" "	26 Aug. 1996	1 Sept. 1996
Clunes District Hospital (b)	30 June 1996	" "	19 Dec. 1996	20 Feb. 1997
Cobram District Hospital	30 June 1996	" "	19 July 1996	8 Aug. 1996
Cohuna District Hospital	30 June 1996	" "	25 Sept. 1996	7 Oct. 1996 (a)
Colac Community Health Service	30 June 1996	" "	26 Sept. 1996	3 Oct. 1996
Coleraine and District Hospital	30 June 1996	" "	28 Aug. 1996	2 Oct. 1996
Corangamite Regional Hospital Services	30 June 1996	" "	17 Sept. 1996	19 Sept. 1996
Dental Health Services Victoria	30 June 1996	" "	26 Sept. 1996	1 Oct. 1996
Donald District Hospital	30 June 1996	" "	19 Aug. 1996	3 Oct. 1996
Dunmunkle Health Services	30 June 1996	" "	9 Sept. 1996	23 Sept. 1996
East Grampians Health Services	30 June 1996	" "	27 Aug. 1996	10 Sept. 1996
Eastern Healthcare Network (b)	30 June 1996	" "	26 Aug. 1996	4 Oct. 1996
Echuca Regional Health	30 June 1996	" "	21 Aug. 1996	17 Sept. 1996
Edenhope and District Memorial Hospital	30 June 1996	" "	23 Aug. 1996	23 Sept. 1996
Far East Gippsland Health and Support Service	30 June 1996	" "	3 Sept. 1996	23 Sept. 1996
Geelong Hospital	30 June 1996	" "	8 Aug. 1996	29 Aug. 1996
Gippsland Southern Health Service	30 June 1996	" "	24 Sept. 1996	30 Sept. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year/period ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
VICTORIAN PUBLIC HOSPITALS AND NURSING HOMES - continued				
Goulburn Valley Base Hospital (b)	29 Feb. 1996	31 Oct. <i>Financial Management Act 1994, s.46.</i>	29 Oct. 1996	11 Nov. 1996
Goulburn Valley Base Hospital	30 June 1996	" "	29 Oct. 1996	20 Nov. 1996
Grace McKellar Centre	30 June 1996	" "	26 Aug. 1996	5 Sept. 1996
Hamilton Base Hospital	30 June 1996	" "	2 Sept. 1996	6 Sept. 1996
Hesse Rural Health Service	30 June 1996	" "	6 Sept. 1996	18 Sept. 1996
Heywood and District Memorial Hospital	30 June 1996	" "	22 Aug. 1996	11 Sept. 1996
Heidelberg Hospital (b)	31 March 1995	" "	14 Mar. 1996	5 June 1996
Inglewood Hospital (b)	31 Dec. 1995	" "	23 Aug. 1996	29 Aug. 1996
Inglewood and Districts Health Service	30 June 1996	" "	12 Sept. 1996	17 Sept. 1996
Inner Healthcare Network (b)	30 June 1996	" "	20 Aug. 1996	25 Oct. 1996
Kerang and District Hospital	30 June 1996	" "	12 Sept. 1996	17 Sept. 1996
Kilmore and District Hospital	30 June 1996	" "	16 Aug. 1996	20 Sept. 1996
Kyabram and District Memorial Community Hospital	30 June 1996	" "	19 Aug. 1996	10 Sept. 1996
Kyneton District Health Services	30 June 1996	" "	4 Sept. 1996	18 Sept. 1996
Latrobe Regional Hospital	30 June 1996	" "	11 Sept. 1996	14 Oct. 1996
Lorne Community Hospital	30 June 1996	" "	30 Aug. 1996	5 Sept. 1996
Maffra District Hospital	30 June 1996	" "	19 Aug. 1996	10 Sept. 1996
Maldon Hospital	30 June 1996	" "	11 Sept. 1996	17 Sept. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

<i>Entity</i>	<i>Financial year/period ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - <i>continued</i>				
VICTORIAN PUBLIC HOSPITALS AND NURSING HOMES - <i>continued</i>				
Manangatang and District Hospital	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	20 Aug. 1996	26 Sept. 1996
Mansfield District Hospital	30 June 1996	" "	27 Aug. 1996	11 Sept. 1996
Maryborough District Health Service	30 June 1996	" "	25 Sept. 1996	26 Sept. 1996
Mclvor Health and Community Services	30 June 1996	" "	19 Sept. 1996	23 Sept. 1996
Mercy Public Hospitals Inc.	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	15 Oct. 1996	24 Oct. 1996 (a)
Mildura Base Hospital	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	30 Aug. 1996	27 Sept. 1996
Mt Alexander Hospital	30 June 1996	" "	8 Aug. 1996	18 Sept. 1996
Myrtleford District War Memorial Hospital	30 June 1996	" "	24 Sept. 1996	2 Oct. 1996
Nathalia District Hospital	30 June 1996	" "	26 Sept. 1996	4 Oct. 1996
North Eastern Healthcare Network	30 June 1996	" "	9 Dec. 1996	23 Dec. 1996 (a)
Numurkah and District War Memorial Hospital	30 June 1996	" "	23 Aug. 1996	19 Sept. 1996
O'Connell Family Centre (Grey Sisters) Inc.	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	10 Oct. 1996	25 Nov. 1996
Omeo District Hospital	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	27 Aug. 1996	17 Sept. 1996
Otway Health and Community Services	30 June 1996	" "	30 Aug. 1996	4 Sept. 1996
Ouyen and District Hospital	30 June 1996	" "	21 Aug. 1996	17 Sept. 1996
Peninsular Healthcare Network	30 June 1996	" "	24 Sept. 1996	4 Oct. 1996
Penshurst and District Memorial Hospital	30 June 1996	" "	9 Sept. 1996	11 Sept. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year/period ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
VICTORIAN PUBLIC HOSPITALS AND NURSING HOMES - continued				
Port Fairy Hospital	30 June 1996	31 Oct. <i>Financial Management Act 1994,</i> s.46.	26 Aug. 1996	11 Sept. 1996
Portland and District Hospital	30 June 1996	" "	19 Aug. 1996	4 Sept. 1996
Queen Elizabeth Centre (Carlton)	30 June 1996	" "	18 Sept. 1996	11 Oct. 1996 (a)
Queen Elizabeth Centre Ballarat	30 June 1996	" "	26 Aug. 1996	18 Sept. 1996
Ripon Peace Memorial Hospital	30 June 1996	" "	18 Sept. 1996	23 Sept. 1996
Rochester and Elmore District Health Service	30 June 1996	" "	26 Aug. 1996	10 Sept. 1996
Seymour District Memorial Hospital	30 June 1996	" "	28 Aug. 1996	24 Sept. 1996
Skipton and District Memorial Hospital	30 June 1996	" "	11 Sept. 1996	20 Sept. 1996
South Gippsland Hospital	30 June 1996	" "	2 Sept. 1996	23 Sept. 1996
Southern Healthcare Network	30 June 1996	" "	2 Sept. 1996	1 Oct. 1996 (a)
St Arnaud District Hospital	30 June 1996	" "	30 Sept. 1996	4 Oct. 1996
St Vincent's Hospital (Melbourne) Limited	30 June 1996	31 Oct. <i>Financial Management Act 1994,</i> s.53 A.	21 Oct. 1996	23 Oct. 1996
Stawell District Hospital	30 June 1996	31 Oct. <i>Financial Management Act 1994,</i> s.46.	13 Sept. 1996	20 Sept. 1996
Swan Hill District Hospital	30 June 1996	" "	13 Sept. 1996	17 Sept. 1996
Tallangatta Hospital	30 June 1996	" "	12 Aug. 1996	26 Aug. 1996
Tawonga District General Hospital	30 June 1996	" "	7 Sept. 1996	8 Oct. 1996
Terang and Mortlake Health Service	30 June 1996	" "	5 Sept. 1996	6 Sept. 1996
Timboon and District Hospital	30 June 1996	" "	17 Sept. 1996	20 Sept. 1996

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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year/period ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
VICTORIAN PUBLIC HOSPITALS AND NURSING HOMES - continued				
Tweddle Child and Family Health Service	30 June 1996	31 Oct. <i>Financial Management Act 1994, s.46.</i>	3 Oct. 1996	10 Oct. 1996
Upper Murray Health and Community Services	30 June 1996	" "	20 Sept. 1996	23 Sept. 1996
Wangaratta District Base Hospital	30 June 1996	" "	22 Aug. 1996	25 Oct. 1996 (a)
Waranga Memorial Hospital (b)	29 Feb. 1996	" "	21 Oct. 1996	24 Oct. 1996
Warracknabeal District Hospital	30 June 1996	" "	2 Oct. 1996	7 Oct. 1996
Warrnambool and District Base Hospital	30 June 1996	" "	23 Aug. 1996	4 Sept. 1996
Western Healthcare Network	30 June 1996	" "	8 Oct. 1996	9 Oct. 1996
West Gippsland Hospital	30 June 1996	" "	23 Aug. 1996	6 Sept. 1996
West Wimmera Health Service	30 June 1996	" "	3 Oct. 1996	15 Oct. 1996
Western Highlands Health Service	30 June 1996	" "	6 Sept. 1996	10 Oct. 1996
Wimmera Healthcare Group	30 June 1996	" "	13 Sept. 1996	20 Sept. 1996
Wodonga District Hospital	30 June 1996	" "	29 Aug. 1996	3 Sept. 1996
Wonthaggi and District Hospital	30 June 1996	" "	6 Sept. 1996	19 Sept. 1996
Women's and Children's Healthcare Network	30 June 1996	" "	24 Sept. 1996	29 Nov. 1996 (a)
Wycheproof and District Health Service	30 June 1996	" "	3 Sept. 1996	4 Sept. 1996
Yarram and District Health Service	30 June 1996	" "	27 Aug. 1996	18 Sept. 1996
Yarrawonga District Hospital	30 June 1996	" "	20 Aug. 1996	3 Sept. 1996
Yea and District Memorial Hospital	30 June 1996	" "	24 Sept. 1996	23 Oct. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year/period ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
INCOMPLETE AUDITS				
Trustees of the Fawkner Crematorium and Memorial Park	31 Dec. 1996	31 Oct. <i>Financial Management Act 1994, s.46.</i>	Audit in progress.	
Trustees of the Keilor Cemetery Trust	31 Dec. 1996	" "	" "	
Trustees of the Memorial Park Altona	31 Dec. 1996	" "	" "	
Trustees of the Mildura Cemetery Trust	31 Dec. 1996	" "	" "	
Trustees of the Preston Cemetery Trust	31 Dec. 1996	" "	" "	
Trustees of the Werribee Cemetery Trust	31 Dec. 1996	" "	" "	

(a) Qualified audit report issued.

(b) Entity abolished as at reporting date and reconstituted to form new healthcare entity.

(c) Entity abolished on 31 July 1995 to form part of a Metropolitan Healthcare Network.

Part 3.3

Infrastructure

KEY FINDINGS

Local government

- A significant proportion of councils failed to meet the legislated reporting deadline of 30 September.
Paras 3.3.4 to 3.3.12
- Consideration should be given to the disclosure within councils' financial statements of related party transactions of councillors and key council officers.
Paras 3.3.25 to 3.3.28
- The 9 relevant councils received \$532.6 million from the privatisation of municipal electricity undertakings.
Paras 3.3.34 to 3.3.43
- The councils did not assess the potential benefits that could be achieved from applying municipal electricity undertakings privatisation proceeds to the elimination of their exposure to unfunded superannuation liabilities.
Paras 3.3.44 to 3.3.47
- An audit survey of major metropolitan and rural councils disclosed that most municipalities had not commissioned reviews of contaminated land and facilities prior to or after council amalgamations to enable the identification and management of associated risks.
Paras 3.3.48 to 3.3.62
- The sale price of \$32 million for the Market Square Centre by the City of Greater Geelong compared favourably with the book value of the Centre of \$28 million, but it should be recognised that the property was revalued downwards by \$4.1 million over the 3 years preceding the sale.
Paras 3.3.63 to 3.3.81



KEY FINDINGS - continued

Public transport

- Expected improvements in fare revenues from reduced fare evasion have not been fully realised due to delays in the introduction of the automated ticketing system. *Para. 3.3.86*
- Over one million passengers were detected by the Public Transport Corporation during 1995-96 as travelling without a valid ticket. *Paras 3.3.95 to 3.3.96*
- The estimated annual cost of fare evasion on suburban passenger trains was approximately \$10 million. Furthermore, surveys indicated that more than 80 per cent of offenders were not in possession of a ticket, with more than 60 per cent asserting that the station from which they had departed had not been staffed. *Para. 3.3.98*
- It is envisaged by the Corporation that the automated ticketing system will be progressively implemented on the remainder of the transport system over a 12 month period, more than 2 years later than originally planned. *Paras 3.3.118 to 3.3.126*
- Substantial delays were experienced in the finalisation of contractual arrangements between the Department of Infrastructure and the private sector provider of the Melbourne to Warrnambool passenger rail service which commenced in September 1993, with the support services agreement not signed until April 1997. *Paras 3.3.137 to 3.3.140*
- While at the launch of the privately provided Melbourne to Warrnambool rail service it was indicated that the arrangement would result in annual savings to the State of \$3 million, the Department had not determined the extent of actual savings, if any, that have been achieved. *Paras 3.3.167 to 3.3.169*
- The Department has not performed a post-implementation review of the contracting-out of the Melbourne to Warrnambool and Melbourne to Cobram services and accordingly there is a possibility that the experiences gained from these arrangements may not be factored into future privatisation proposals. *Para. 3.3.170*

Urban Land Authority's treatment of project development fee

- Audit found it difficult to establish a direct link between the specific powers of the Authority, which mainly relate to the purchase and sub-division of land and the provision of associated infrastructure, and its treatment of a \$235 000 project development fee which was provided to the National Gallery of Victoria for the purchase of a painting. *Paras 3.3.174 to 3.3.178*



3.3.1 The Minister for Planning and Local Government, the Minister for Roads and Ports, and the Minister for Transport have responsibility for operations within the Infrastructure sector. These Ministers have collective responsibility for the Department of Infrastructure.

3.3.2 Details of the specific ministerial responsibilities for public bodies within the Infrastructure sector are listed in Table 3.3A. These public bodies, together with the Department of Infrastructure, were subject to audit by the Auditor-General during the 1995-96 financial year.

**TABLE 3.3A
MINISTERIAL RESPONSIBILITIES FOR PUBLIC BODIES
WITHIN THE INFRASTRUCTURE SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Planning and Local Government	Architects Registration Board of Victoria Building Control Commission City of Melbourne Superannuation Fund (a) CityWide Service Solutions Pty Ltd Docklands Authority Heritage Council Loddon-Campaspe Regional Planning Authority (b) Melbourne City Link Authority Municipal councils (78) Plumbers, Gasfitters and Drainers Registration Board Prahran Market Pty. Ltd. Regional Library Corporations (9) Urban Land Authority
Roads and Ports	Marine Board of Victoria Roads Corporation
Transport	Public Transport Corporation

(a) Fund abolished with members' benefits transferred to the Local Authorities Superannuation Board effective 1 November 1995.

(b) Authority abolished 1 July 1996.

3.3.3 Comment on matters of significance arising from the audit of entities within the Infrastructure sector is provided below.





FINANCIAL REPORTING IN LOCAL GOVERNMENT

3.3.4 An important element of the Government’s wide-ranging reform program for the local government sector was the introduction of legislation in the Parliament in 1994-95 to improve the financial accountability of the sector and, in particular, to extend the audit mandate of the Auditor-General to include local government entities. The Minister for Local Government, when introducing the enabling legislation in the Parliament, indicated that the benefits expected to arise from the Auditor-General’s involvement in local government would include:

- a greater consistency in accounting treatments and disclosures across the State, thereby improving the usefulness of the financial information provided by councils;
- an improved ability for the Government and ratepayers to identify significant financial issues impacting on councils; and
- an enhanced ability to gain an overall snapshot of local government.

3.3.5 In conducting the financial audits of local government entities for the year ended 30 June 1996, my Office engaged private sector resources to assist in the audit of 87 council and associated entities, and conducted the audit of 2 entities using internal resources in order to maintain a direct involvement in the sector. The direct strategic involvement enables my Office to:

- gain knowledge of the issues facing the industry in the management of public sector risk; and
- maintain appropriate skill levels to control the effectiveness of contractors, thereby achieving the benefits expected by the Government to arise from the involvement of my Office in the external audit arrangements for the sector.

3.3.6 **The Office of Local Government, which forms part of the Department of Infrastructure, has played a pivotal role in facilitating improvements in the financial reporting practices of municipal councils through the development and issue of various guidance releases, policy statements and accounting manuals. In addition, that Office has shown a commitment to improving the timeliness of financial reporting to the Minister. However, there remain several areas where the Office of Local Government needs to provide further guidance to councils and associated entities to enhance the standard of public sector financial reporting.**

3.3.7 The majority of the financial reporting issues highlighted in this Report can be overcome with extra guidance provided by the Office of Local Government and care taken in the preparation of the financial statements, together with the establishment of appropriate quality assurance processes by councils.



Timeliness of reporting

3.3.8 An important determinant of the effectiveness of financial reporting is the timeliness of the provision of information to stakeholders and other interested parties, such as ratepayers, lenders, neighbouring councils and the State Government. The *Local Government Act* 1989 prescribes that a council’s annual report, including the audited financial and compulsory competitive tendering (CCT) statements, must be forwarded to the Minister for Planning and Local Government within 3 months of the end of the financial year.

3.3.9 To enable councils to satisfy the above legislative reporting date, a deadline of 2 September 1996 was set by my Office for councils to submit their completed statements for review and the issue of my audit opinion. However, by 9 September 1996, 63 local government entities (71 per cent) had not complied with this reporting deadline. Furthermore, by 30 September 1996, 25 entities (28 per cent) still had not provided the requisite information to my Office.

3.3.10 The *Local Government Act* 1989 provides that the timeframe for annual reports to be forwarded to the responsible Minister may be varied only at the Minister’s discretion. **In respect of the financial year ended 30 June 1996, the Minister granted 63 extensions to council reporting periods. However, 7 councils exceeded the Minister’s approved extended timeframe.** The failure of councils to meet the legislated reporting deadline of 30 September mainly arose due to :

- the low priority given by the councils to the year-end external reporting process, impacting on the quantum and quality of resources devoted to the process; and
- the identification by my Office of major deficiencies, errors of fact and inconsistencies in financial statements, which required amendment.

3.3.11 While there was a substantial improvement in the timeliness of the financial statement completion as compared with previous financial years, the fact that 63 extensions were granted to the established reporting timeframe indicates that the information contained in the 1995-96 annual reports was not provided to stakeholders in a timely manner.

3.3.12 The need for the Minister to extend the legislated reporting timeframe would be reduced if councils devoted appropriate resourcing to the external reporting processes and implemented adequate quality assurance procedures in relation to these processes. Furthermore, the performance of the sector would be further enhanced by the Office of Local Government developing a best practice financial statement format for use by all councils and ensuring the causes of reporting extensions are analysed and addressed for future years.

Compliance with accounting standards

3.3.13 Given the importance of external financial reporting as part of the public accountability process, it is incumbent upon the preparers of local government external financial reports to ensure that the information conveyed to users is complete, free of error and provided in a timely manner. Furthermore, it is the responsibility of the controlling central agency, the Office of Local Government, to advise councils and related entities on policy, regulations and the application and interpretation of accounting standards impacting upon external financial reporting. Accordingly, the development of accounting and financial reporting requirements and related guidance statements by the Office of Local Government is essential to ensuring the effective financial accountability of local government.

3.3.14 Councils are currently required by legislation to prepare their external financial statements in accordance with Australian Accounting Standards, particularly Australian Accounting Standard AAS 27 entitled *Financial Reporting by Local Governments*, and to satisfy the reporting requirements included in the *Local Government Act 1989* and the *Local Government Regulations 1990*.

3.3.15 During the 1995-96 financial year, the vast majority of councils and related entities complied with the Australian Accounting Standards and legislative disclosure requirements. Specifically, 83 local government entities received confirming audit opinions while the audit opinions on the financial statements of 6 entities were qualified. Table 3.3B shows the underlying reasons for the issue of the non-confirming Auditor-General opinions on the financial statements of local government entities.

**TABLE 3.3B
BASIS OF NON-CONFIRMING
AUDITOR-GENERAL OPINIONS, 1995-96**

<i>Issue</i>	<i>No.</i>
Inadequate or unreliable fixed asset records	4
Grants received in advance not recognised as income	2

3.3.16 In addition, one council received a non-confirming opinion in respect of its CCT statement required in accordance with the *Local Government Act 1989*, due to inadequate record-keeping.

3.3.17 During 1995-96, the Office of Local Government developed and issued to councils 3 specific accounting guidance papers relating to the valuation of land under roads, depreciation and CCT, and CCT reporting. **Given that it was found necessary to issue non-confirming audit opinions, it is important that the Office of Local Government continues to provide pro-active strategic accounting guidance to the local government sector, including model financial and CCT statements.**

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Other emerging issues

3.3.18 During 1995-96, the Office of Local Government actively worked to improve the standard of financial reporting by issuing accounting policy and best practice guides. However, there are still a number of issues requiring attention, as outlined below.

Asset identification, recording, valuation and reporting

3.3.19 With the introduction of Australian Accounting Standard AAS 27 *Financial Reporting by Local Governments* in 1992, councils were required to identify, value, record and report within their annual financial statements all assets acquired prior to October 1992 within a 5 year period expiring on 30 June 1997. All expenditure of a capital nature incurred after October 1992 was to be immediately recognised as an asset within the financial statements.

3.3.20 The audit review of the 1995-96 annual financial statements of councils revealed that at 30 June 1996 the majority of councils had not brought to account all their infrastructure assets. Given the difficulties experienced to date in relation to fixed asset disclosures and the large quantum of assets expected to be brought to account by councils in 1996-97, it is likely that there will be significant related issues that will need to be addressed by councils during the 1996-97 financial year. In addition, where councils bring to account such assets during the financial year, rather than at the end of the financial year, there will be a significant increase in the dollar value of the legislated CCT target to be achieved by councils as a consequence of the impact of increased depreciation arising from the recognition and depreciation of those assets for the first time.

3.3.21 **It is important that councils identify and value all infrastructure assets in a timely manner and that the valuation process and outcomes be independently reviewed by councils' internal auditors and audit committees, prior to their inclusion in the 1996-97 financial statements, to ensure delays and non-confirming audit reports are avoided.**

Consolidation of subsidiary entities

3.3.22 Australian Accounting Standard AAS 24 *Consolidated Financial Reports* requires that where one entity is directly or indirectly controlled by another, the financial transactions of the 2 entities should be combined and reported by way of consolidated financial statements.



3.3.23 However, audit noted certain cases, in respect of the 1995-96 financial year, where trust funds and companies were controlled by councils and there was a reluctance to disclose the financial affairs of these controlled entities in the form of group accounts. **Where these entities receive significant public resources, it is important that public accountability is not diluted by the failure to report the financial activities in a consolidated format.**

3.3.24 Furthermore, a number of councils had recognised within their financial statements operations which had been depicted as separate reporting entities when, in fact, they constituted segments of the council. In the majority of instances, these operations related to Special Committees created under section 86 of the *Local Government Act 1989*. **The Office of Local Government should issue appropriate guidance to councils on the reporting of the operations of special committees.**

Disclosure of related party transactions

3.3.25 The *Local Government Act 1989* imposes obligations on councillors and executive management to declare any pecuniary interests on their appointment and on an annual basis, with such declarations being open to public inspection. However, despite the disclosure of pecuniary interests, there is no requirement for councils to disclose within their financial statements any council transactions with entities or activities associated with councillors, referred to as related party transaction disclosures.

3.3.26 In the private sector, the Corporations Law requires disclosure of related party transactions. This requirement is complementary to the requirements of Australian Accounting Standard AAS 22 *Related Party Disclosures* which applies to private sector reporting entities.

3.3.27 During 1995-96, the Department of Treasury and Finance issued guidance under the *Financial Management Act 1994*, entitled *Responsible Persons Disclosures*, requiring the disclosure of the salaries and any related party transactions of key officers of public sector agencies. However, such guidance does not apply to local government entities.

3.3.28 **In my view, the same standard of accountability and disclosure demanded of private sector directors and executives and other public sector managers should be applied to the local government sector.**

Regulatory deficiencies

3.3.29 During the 1995-96 financial year, the audit review found that certain elements of the current local government regulations required amendment as they were either outmoded or acted as an impediment to quality financial reporting. In particular, under the current regulations:

- Persons designated as principal accounting officers are not obliged to hold an accounting qualification or to be members of a recognised Australian professional accounting body, or to state their professional credentials in the statutory management report accompanying the financial statements;
- There is no requirement for the CCT statement, and a performance statement which is to be prepared from July 1998, to be adopted by council prior to audit by the Auditor-General;



- Two councillors are required to sign the annual financial statements of council in their own right, rather than on behalf of council. Therefore, under this arrangement, there is no declared collective responsibility assumed by council for their annual financial statements; and
- Provision exists for quarterly statements to be presented to council which reflect actual results against the rates determination budget but such provisions do not require such statements to be presented on an accrual basis.

3.3.30 Although the *Local Government Regulations 1990* have been recently amended, further scope exists to enhance the Regulations to ensure that their requirements reflect best management practice.

Performance statement

3.3.31 From the 1998-99 financial year, a council's annual report will be required to include an audited performance statement which outlines:

- the performance targets and measures shown in the business plan and corporate plan for that year; and
- the extent to which those targets and measures were achieved.

3.3.32 Although this is a recent initiative, audit found that no guidance had been provided to councils as to:

- the qualitative and quantitative measures to be developed;
- the nature and extent of any mandatory disclosures; and
- the format of the performance statement.

3.3.33 To enable the efficient and effective production by councils of the performance statement, it would be advantageous for the Office of Local Government and certain nominated councils to participate in a pilot program whereby the preparation and audit of performance statements were undertaken for the 1996-97 and 1997-98 reporting cycle. To assist in this pilot program, the Office of Local Government should develop guidance on the mandatory requirements of the performance statement.



□ RESPONSE provided by Deputy Secretary, Department of Infrastructure

Timeliness of reporting

The 1995-96 financial year was the first year in which councils had a 3 month reporting deadline and the audits were made the responsibility of the Auditor-General. Given these parameters, it is acknowledged there were some teething problems and some councils performed poorly. It is expected that performance will improve for 1996-97. However, the prime responsibility for timely annual reports clearly rests with councils, their executive and elected councillors.

The Office of Local Government will work with the Office of the Auditor-General and the industry to develop best practice financial statement formats for use by all councils.

Compliance with accounting standards

The Office of Local Government where necessary will provide guidance to the industry. However, it is considered that the performance of the local government sector for 1995-96 was good with 92.7 per cent compliance indicative of good accounting practice. It is considered that the non-conforming opinions did not involve issues related to probity or solvency.

Subsidiary entities

The question of whether councils should consolidate subsidiary entities will depend on the facts of each case reflecting the capacity to control decision-making by an entity as defined under AAS24. If councils did not comply with the relevant accounting standards or prepared the financial statements inconsistent with the underlying relationships and transactions then such omissions should be adequately dealt through the issue of non-conforming audit opinions if the matter is deemed material.

Related party disclosures

The Office of Local Government agrees that local councils should be required to report related party transactions and a guideline is currently under preparation addressing this issue.

Legislative enhancements

The Office of Local Government supports the need for continual improvement to the legislating framework and appropriate changes will be made where deemed appropriate.

Performance statements

Work has already commenced on the development of performance indicators for inclusion in performance statements. Councils are directly involved in this work and it is intended that a "model" performance statement will be prepared.





TRANSFER OF MUNICIPAL ELECTRICITY UNDERTAKINGS

3.3.34 In previous Reports to the Parliament, I have commented on the Government’s extensive reform of the State’s electricity industry, including:

- the creation of 5 electricity distribution companies;
- the assumption by these companies of the distribution operations of the State’s electricity industry, including the services previously provided by 11 municipal electricity undertakings (MEUs) owned by 9 metropolitan councils, which accounted for around 15 per cent the State’s electricity supply; and
- the sale of the electricity distribution companies by the State which generated very favourable returns.

Council entitlements to privatisation proceeds

3.3.35 To facilitate the Government’s privatisation program, the *Electricity Industry Act* 1993 authorised the Treasurer to enter into agreements with councils for:

- the transfer of their MEU facilities to the State for inclusion in 3 metropolitan electricity distribution companies; and
- consideration payable by the State for the transferred assets and liabilities.

3.3.36 Consequently, in September 1994 the Government and the 9 relevant metropolitan councils entered into an MEU Transfer Agreement, the key provisions of which included:

- absolute control of the distribution companies to rest with the State;
- annual dividend entitlements to be provided to the relevant councils of about \$25 million until the privatisation of the distribution companies;
- an entitlement by the councils to a share of the net privatisation proceeds, consisting both of a return of equity contributed and a share of the profits arising from the sale of the distribution companies;
- the method of calculation of each council’s economic entitlement upon privatisation;
- the ability of councils to request a cash settlement in lieu of their economic entitlements; and
- access by councils to the financial reports of the distribution companies and any expert determinations undertaken by the State in regard to the value assigned to these companies.

3.3.37 At the time of signing the Agreement, the value of the MEU assets and liabilities transferred by councils was subject to adjustment, arising from the results of due diligence audit reviews implemented by the State.

3.3.38 Although the existing agreement provided that councils could require the State to make a cash settlement offer in advance of the actual sale of each company, the Government subsequently approached individual councils to renegotiate their entitlement to the privatisation proceeds prior to the sale of each metropolitan distribution company. The reasons for these renegotiations, were that:

- the existing Agreement allowed for a wide range of possible outcomes;
- additional value had been added to the distribution companies, exclusively as a result of government decisions taken after the creation of the companies, the benefit of which should accrue to the State as a whole; and
- the Government's position had always been that councils should receive a fair reflection of their contributions, and hence should neither be financially penalised nor receive unwarranted financial windfalls as a result of the restructuring of the electricity industry.

3.3.39 The Government also advised councils that if a new agreement could not be reached, then appropriate orders would be issued under existing legislation to ensure that the appropriate outcome pursuant to the provisions of the MEU Transfer Agreement was achieved prior to the completion of the sale of the distribution companies.

3.3.40 Following this advice and the renegotiations undertaken by the Department of Treasury and Finance, a series of *MEU Cash Offer Agreements* were entered into between the State and the individual councils which established the revised entitlement basis to privatisation proceeds to be received by councils.

3.3.41 The proceeds paid to councils between September 1995 and February 1996 under the *MEU Cash Offer Agreements* are detailed in Table 3.3C.

TABLE 3.3C
MEU PRIVATISATION PROCEEDS PAID TO COUNCILS
(\$million)

<i>Council</i>	<i>Proceeds paid to councils</i>	<i>Proceeds relating to the sale of the distribution companies</i>		
		<i>CitiPower</i>	<i>Solaris</i>	<i>United Energy</i>
Melbourne	206.9	206.9	-	-
Darebin	72.2	26.5	45.7	-
Whitehorse	62.0	-	-	62.0
Moreland	50.9	26.1	24.8	-
Maribyrnong	45.5	-	45.5	-
Manningham	33.0	-	-	33.0
Banyule	30.4	-	30.4	-
Port Phillip	18.1	18.1	-	-
Hobsons Bay	13.6	-	13.6	-
Total	532.6	277.6	160.0	95.0

3.3.42 A comparison was undertaken by audit of the proceeds actually received by the councils with the book values recorded by the councils of the MEUs net assets transferred to the State following the completion of due diligence audit reviews, the “stand alone” values of the MEU business as determined by the Government’s financial advisers and the net asset value of the MEUs brought to account by the distribution companies. The comparison was undertaken to determine the adequacy of returns received by municipalities. Details of the comparison are shown in Table 3.3D.

TABLE 3.3D
COMPARISON OF PROCEEDS RECEIVED BY COUNCILS WITH
VARIOUS VALUES ASSIGNED TO TRANSFERRED MEU NET ASSETS
 (\$million)

<i>Council</i>	<i>Proceeds received (a)</i>	<i>Book value of MEU net assets recorded by councils</i>	<i>MEU “stand alone” values as determined by government advisers</i>	<i>Value assigned to MEU net assets brought to account by the distribution companies (b)</i>
Melbourne	206.9	84.8	116.4	232.4
Darebin	73.2	34.2	36.7	65.9
Whitehorse	62.0	35.0	44.2	89.4
Moreland	51.9	24.0	26.5	58.0
Maribyrnong	46.5	20.4	28.2	52.9
Manningham	33.0	24.2	20.8	72.5
Banyule	31.4	16.6	17.6	38.3
Port Phillip	18.1	12.0	8.6	21.7
Hobsons Bay	14.6	9.4	11.0	28.1
Total	537.6	260.6	310.0	659.2

(a) Includes dividends of \$5 million paid to the councils prior to sale.

(b) As per the Allocation Statement issued in March 1995 which amended original values transferred to reflect industry restructuring outcomes as a result of policy decisions by government, principally relating to cross subsidy and tariff matters.

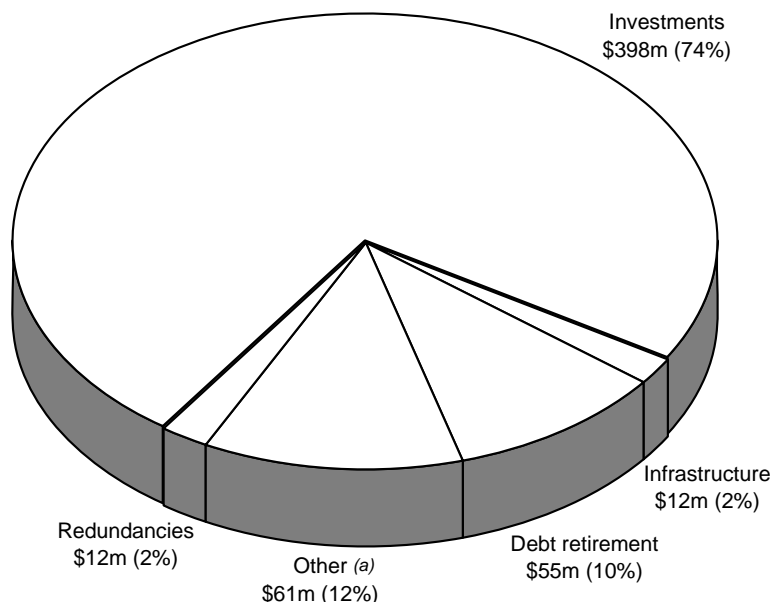
Source: Department of Treasury and Finance.

3.3.43 While the proceeds actually received by councils from the privatisation process exceeded the book value recorded by councils of the MEU net assets transferred and the MEU “stand alone” values as determined by the Government’s advisers, the proceeds received were below the values of the MEU net assets (as adjusted for industry restructuring outcomes) allocated by the Government to the newly created distribution companies prior to their sale.

Application of privatisation proceeds

3.3.44 The *MEU Cash Offer Agreements* did not prescribe the manner in which councils were to apply their share of the privatisation proceeds, therefore they were able to exercise discretion in the use of these proceeds. Chart 3.3E indicates the application of the privatisation proceeds by councils up to 30 June 1996, based on advice provided by the councils.

CHART 3.3E
APPLICATION OF MEU PRIVATISATION PROCEEDS BY COUNCILS



(a) Mainly comprises a \$50 million contribution by the Melbourne City Council to the Federation Square development, a joint project with the State for the revitalisation of the Jolimont railyards and adjoining areas within the Melbourne central business area.

3.3.45 The above chart indicates that the vast majority of the privatisation proceeds (\$398 million or 74 per cent) were retained and invested by councils in order to:

- replace income formerly generated by MEU operations;
- reduce reliance on rate revenues; and
- provide for future works programs.

3.3.46 In addition, \$55 million of the proceeds were applied towards debt reduction resulting in annual interest cost savings of around \$6.5 million.

3.3.47 The decision taken by councils concerning the disposition of the privatisation proceeds was, in the majority of cases, based on internal assessments prepared in accordance with individual council priorities. However, the councils did not assess the potential benefits that could be achieved from applying these proceeds to the elimination of their exposure to unfunded superannuation obligations.



CONTAMINATED LAND SITES

3.3.48 Since the discovery of soil contamination at certain sites associated with a number of Victorian residential development projects, notably the Bayside Development site at Port Melbourne, there has been an increased public awareness of the risks to human health arising from contaminated land.

3.3.49 Contamination of land sites is the outcome of past industrial and land use practices, with these sites consequently representing potential threats to human health, especially when rezoned for residential and public use without adequate remediation.

3.3.50 The exposure of councils to risks associated with contaminated land sites was highlighted in over one-third of the due diligence audit reports issued to Commissioners by my Office during the recent restructuring of municipalities. In the light of the due diligence audit findings, and the potential risks to ratepayers arising from any inappropriate use of contaminated sites, a specific audit review was undertaken of contaminated sites controlled by municipalities and the adequacy of council policies and practices to manage these risks.

Contaminated sites within municipalities

3.3.51 The Victorian Environment Protection Authority (EPA) is the lead government agency responsible for environmental matters, including the monitoring of contaminated sites. The EPA, as part of its monitoring function, maintains 2 registers of contaminated sites which record:

- *Priority sites*, which pose a significant risk to human health and the environment. The owners of such sites have been informed that “clean-up” notices apply which remain in force until a certificate of environmental audit has been issued by an independent environmental auditor. The register details are updated regularly and are accessible through the Department of Treasury and Finance’s *LANDATA* service; and
- *Contaminated information sites*, for which clean-up action is not required until a change in current land use is proposed. This register is also updated regularly and extracts from the register are provided to municipalities and other planning authorities twice a year.

3.3.52 The audit review of the priority site register indicated that there were no declared contaminated sites that were controlled by metropolitan councils whereas rural municipalities owned 3 of the 16 declared priority sites. Two of the priority sites were contaminated by arsenic, mercury and lead and had been previously used by councils as pre-school sites. However, audit noted that the pre-school services had been relocated and that the sites are currently vacant. The remaining site relates to part of an aerodrome that had been contaminated by the wash-down of aircraft used in aerial spraying. “Clean up” notices were currently in force for all sites.

3.3.53 The review of the contaminated information site register revealed that 5 of the 69 declared contaminated sites were controlled by rural councils whereas metropolitan councils controlled 4 sites.



3.3.54 Notwithstanding the details of contaminated sites held by the EPA, the Authority advised audit that regular monitoring of such sites did not commence until 1990 and most sites currently identified have arisen as a consequence of reviews conducted as part of land redevelopment proposals. **The EPA indicated that unidentified contaminated land sites may exist, particularly in rural municipalities where mining operations were conducted during the last century.**

3.3.55 Given the current level of identified contaminated land and the probability that additional contaminated sites may exist, scope exists for local government to systematically:

- identify all contaminated sites controlled by councils;
- determine the exposures arising from those sites; and
- develop remediation programs for sites posing risks to human health and the environment.

Environmental management within municipalities

3.3.56 Responsibility for the identification and management of contaminated sites within local government rests ultimately with individual councils. Councils need to ensure that appropriate policies and processes exist to enable contaminated sites to be readily identified, the associated risks to be assessed and appropriate remediation programs to be implemented. To assist in this process, the EPA has issued a publication entitled *Planning Measures for Environment Protection* which has been provided to all councils as a practical guide on environmental management issues.

3.3.57 An audit survey of major metropolitan and rural councils conducted to determine the extent of environment controls within municipalities disclosed that such controls are generally poor. Most municipalities responded that:

- reviews of contaminated land and facilities had not been commissioned prior to or after council amalgamation;
- environmental reviews of land and facilities were not undertaken on a regular basis;
- environmental risk management policies and procedures had not been developed; and
- more than 50 per cent of surveyed councils did not have on hand a copy of the EPA's guidelines.

3.3.58 The absence of clear policies and procedures for environmental management within municipalities creates the risk that contamination sites will not be identified thus exposing municipalities to potential costs at some future time.

3.3.59 Municipalities should ensure that an environmental control regime is established to identify and manage the risks associated with contamination of land and facilities.



Financial reporting of contaminated land

3.3.60 An audit review of councils’ 1995-96 financial statements revealed that **the majority of councils did not disclose the extent of their exposures related to contaminated assets.**

3.3.61 The disclosure of council exposure to contaminated land and associated remediation costs, within their financial statements, would aid ratepayers and the wider community to assess the economic impact of contamination. In addition, the regular valuation of contaminated sites would enable councils to identify any potential losses resulting from contamination. Such costs may be significant and the non-provision for future remediation costs may impose severe financial constraints on municipalities when remediation work is required, leading to either additional borrowings or service reductions.

3.3.62 **It is considered that municipalities should ensure that financial statements fully disclose costs associated with site contamination and any future remediation works.**

RESPONSE provided by Deputy Secretary, Department of Infrastructure

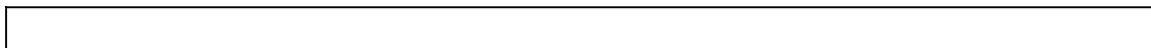
Audit’s findings in relation to contaminated sites have been noted and will be drawn to the attention of all councils.

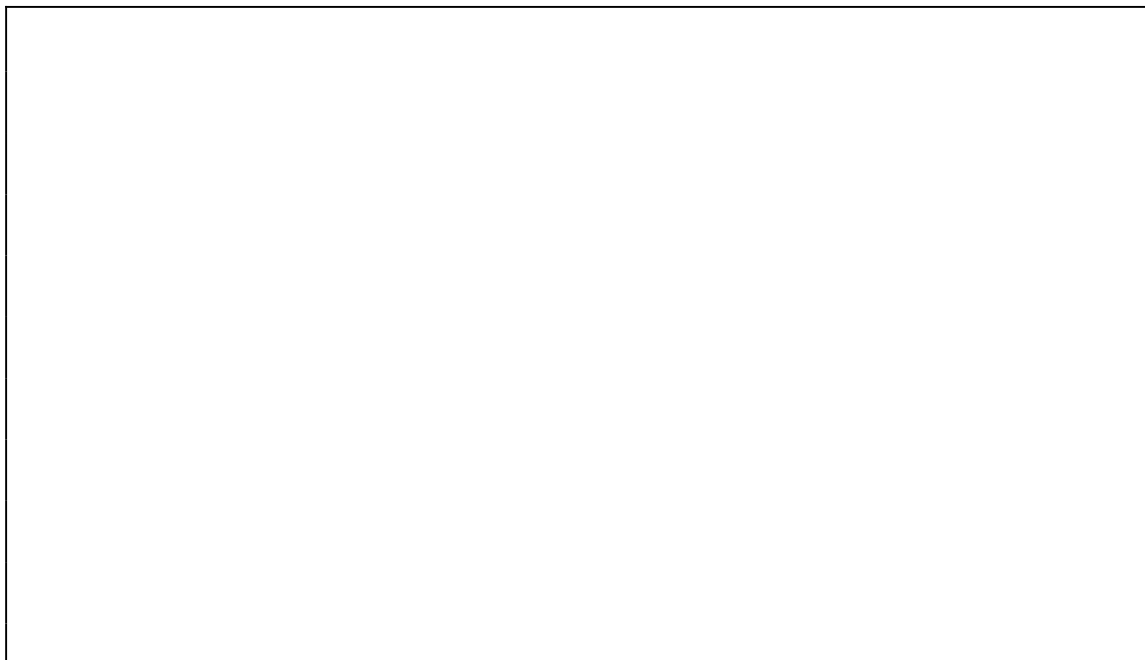
DIVESTMENT OF RETAIL DEVELOPMENT AT GEELONG

3.3.63 During the 1980s, a number of councils became involved in the development of retail shopping complexes and, in several instances, experienced adverse financial exposures as a consequence of their involvement in these developments. The Quayside centre at Frankston and the Stud Park complex at Rowville are examples of retail shopping centre developments which have either resulted in financial loss to participating councils or currently have the potential to cause significant loss.

3.3.64 Certain participating councils have acted to eliminate their on-going exposure to known or potentially unprofitable retail developments by selling their stake in these projects. Audit undertook a review of the processes undertaken by one council, namely the City of Greater Geelong, to divest itself of its holdings to ensure that ratepayers interests were maximised.

3.3.65 During the early 1980s, the former Geelong City Council sought to stimulate investment and attract shoppers and tourists into the Geelong central business district by constructing a retail shopping centre. The Council determined that it would act as the facilitator of the development and sought suitable investors to construct the complex. However, as this process was unsuccessful, the Council determined that it would directly undertake the project in its own right. Subsequently, in 1984, the Geelong Market Square retail shopping complex (the Centre) was constructed on Crown land at a cost of approximately \$32 million, financed from borrowings.





Market Square, Geelong.

3.3.66 The *Geelong Market Site Act 1983* empowered the Council to undertake the redevelopment and to manage the Geelong market site as a shopping complex. Once constructed, the Centre was managed by the former Geelong City Council on a commercial basis, with separate accounts maintained as required by the legislation. The Council was prohibited, under the legislation, from using rate revenues or other Council funds to support the operations of the Centre. Equally, funds generated by the Centre could not to be utilised for council programs.

3.3.67 When the Centre was opened, it immediately attracted high rentals which offset its operating and financing costs. However, rental income and tenancy rates subsequently decreased in real terms due to economic factors, insufficient infrastructure enhancement, and increased competition arising from the establishment of a neighbouring shopping centre. Table 3.3F highlights the Market Square Centre’s financial performance over recent years.

TABLE 3.3F
FINANCIAL ANALYSIS OF THE CENTRE, 1990-91 to 1995-96
 (\$)

Year	Total income	Operating costs	Finance costs	Surplus/ (Deficit)
1990-91	5 952 500	1 256 270	4 325 720	370 510
1991-92	5 052 230	1 402 580	4 335 930	(686 280)
1992-93	4 315 800	1 188 980	3 126 210	(a) 610
1993-94	4 573 000	1 202 000	2 171 000	(a) 1 200 000
1994-95 (b)	3 351 000	806 000	1 645 000	(a) 900 000
1995-96	(c) 5 389 000	1 088 000	2 112 000	2 189 000

(a) Excludes revaluation decrements totalling \$4.1 million.
 (b) Reporting period is for 9 months.
 (c) Excludes the net proceeds from the sale of the Centre.



3.3.68 In 1993, the Commissioners of the newly created City of Greater Geelong determined that the Council should sell its interests in the Centre.

Process of sale

3.3.69 The Centre was advertised for sale by tender with a closing date of 15 March 1993. However, the tender process failed to attract any conforming bids but, over the ensuing weeks, a number of written proposals were received, including an offer of \$27 million.

3.3.70 As none of the bidders were prepared to commit themselves to a contract or to submit an unconditional bid, the Council formally withdrew the property from sale in June 1993.

3.3.71 The decision to place the property on the market again, during September 1995, was based on expert advice that the retail sector was nearing the peak of its growth cycle and was expected to decline due to the number of retail expansions currently under way in Victorian regional centres. In particular, the property adviser indicated to the Council that 2 options were available to it in regard to the Centre, namely:

- in the short term, to maximise its current income and implement a selling strategy in the first quarter of 1996; and
- in the long term, to commence discussions with the owners of an adjoining complex to establish a physical linkage between the 2 Centres to make them a super regional retail complex that would result in increased patronage over the ensuing period.

3.3.72 Prior to proceeding with the sale option, the Council attempted to establish a linkage with the adjoining complex, but as that was unsuccessful, it implemented a strategy which increased its rental revenue through the letting of previously unoccupied areas.

3.3.73 The expert property adviser was subsequently appointed as sole agents for the sale, with the Centre marketed both locally and off-shore. Under the marketing strategy employed by the adviser, a public tender process was implemented which resulted in only one offer of \$30 million. Despite the poor response to the tender process, other parties did express an interest in the Centre which enabled the Council to enter into sale negotiations with a number of interested parties. These negotiations were successful in attracting preliminary offers ranging from \$28.5 million to \$30.7 million. However, discussions with the bidders resulted in the offers increasing, ranging between \$30 million and \$33.3 million, nevertheless, the Council rejected the offers as they contained unacceptable conditions. Further discussions resulted in only 2 acceptable bids, being for \$31 million and \$32 million respectively.



3.3.74 In order to analyse the offers made, an internal financial evaluation was undertaken in January 1996. The overall recommendation arising from the evaluation was that, in order to minimise risk, the Council should sell the Centre for at least \$33 million, which was equivalent to the value of the property based on current income levels and an estimated yield of 12.5 per cent. However, a higher figure of \$34.5 million was established as the minimum reserve price for the Centre. It was also concluded from the evaluation that it was possible for the value of the Centre to improve, should it be retained by the Council, based on rental income projections over the next 5 years and the Council being willing to fund short-term cash flow deficits. However, this option was not supported due the unacceptable risk of achieving the projected increased revenues over the next 5 years.

3.3.75 On 4 March 1996, at a special meeting, the Council determined that:

- the sale of the Centre only proceed if the highest bidder was willing to pay \$32 million for the purchase of the property;
- a non-refundable deposit be obtained; and
- in the event that these conditions are not agreed between the parties, the Council’s Chief Executive Officer be authorised to enter into negotiations with all bidders to achieve a satisfactory alternative purchase arrangement.

3.3.76 The conditions of sale for the Market Square Centre at a price of \$32 million were accepted by the highest bidder and the contract of sale was subsequently signed on 12 March 1996, with a settlement date of 28 June 1996.

Analysis of the sale process

3.3.77 The sale price of \$32 million compared favourably with the book value of the Centre of \$28 million. After taking into account the cost of sale of approximately \$500 000, the profit on the sale was \$3.5 million, but it should be recognised that the property had been revalued downwards by \$4.1 million over the preceding 3 years.

3.3.78 The audit review of the sale found that the agreement to sell the Centre was entered into prior to Council receiving an independent valuation report, as required by the *Local Government Act* 1989. A valuation report, which was subsequently received by the Council on 25 March 1996, indicated that the market value of the Centre was \$31.5 million as at 19 February 1996, which was fortunately lower than the sale price already agreed by Council.

3.3.79 An analysis of the net proceeds achieved from the sale of the Centre, based on a conservative return on investment of 8 per cent, indicated a net annual return to Council of only \$196 000. During the 1995-96 financial year, the Centre achieved a net return to Council of \$2.2 million and projections to the year 2000 indicated that the Council would have achieved estimated annual returns in excess of \$1 million per annum if the Centre had been retained.



3.3.80 Consequently, a **higher level of return may have been achieved by the Council from the retention of the Centre**. But, as indicated previously, the Council was not willing to retain the Centre as it was not considered to be "core business" and its retention adversely restricted the borrowing ability of the Council. Furthermore, a 1995 review by the Council identified that the financial position of the City was not sustainable at its current level of operations. The review identified that a number of significant actions had to be undertaken to arrest the Council's declining financial position, including an assessment of the Council's continued ownership of the Centre.

Council application of sale proceeds

3.3.81 The audit review identified that the total sale proceeds of \$32 million, plus interest on the sale deposit, were mainly applied by Council as follows:

- repayment of \$2.3 million of borrowings associated with the Centre;
- initial investment of \$13.4 million (being the balance of the borrowings associated with the Centre which attracted an interest cost of 6.86 per cent which is repayable in March 1998) earning annual interest at a rate of 7.2 per cent;
- the reduction of \$13 million of Council's general borrowings; and
- the allocation of \$3 million to a reserve for civic accommodation of which \$350 000 had been spent on changes to the town hall.

□ RESPONSE provided by The City of Greater Geelong

The financial analysis table refers to the overall performance of the shopping centre and the net return to the City. An analysis on the net return on the City's equity in the shopping centre would have indicated a healthy return on equity given the extent of liquidity gearing.

While independent advice received by the City indicated that the retail sector was nearing the peak of its cycle, the decision to sell was also influenced by the issues of:

- *the operation of a shopping centre was not seen as being a core business activity of the City; and*
- *the outstanding loans on the shopping centre were taken into account in determining the global borrowing capacity of the City.*

The Report could be misinterpreted to imply that there was no ongoing strategy to increase rental income by the leasing of unoccupied areas. To maximise income levels this was an ongoing strategy.

A linkage to the adjacent shopping centre had been discussed on a number of occasions in previous years, as this strategy was considered in the best interests of the 2 centres. This issue, however, did not have a bearing on the decision to proceed to sell the shopping centre.

With reference to the proceeds of sale, this statement could be misinterpreted in that when evaluating the net return from any investment there are 2 elements to be taken into account, namely the capital profit/loss on sale, and the overall return generated from the investments. The latter issue as highlighted before has not been assessed.

In regards to the comment on the date of receiving the valuation report, the inference in this statement is that the City only became aware of the valuation on the date of receiving the report, whereas in fact officers from the City had been verbally advised of the valuation prior to receiving the report.





**PUBLIC TRANSPORT REVENUE PROTECTION,
PATRONAGE LEVELS AND AUTOMATED TICKETING SYSTEM**

3.3.82 In the 1995-96 financial year, the Public Transport Corporation collected in excess of \$238 million in fare revenue from around 236 million journeys undertaken by passengers across all modes of public transport. Historically, a substantial proportion of the Corporation's operating expenditure has related to fare collection activity, including the provision of conductors on trams, staffed rail stations and revenue support staff, with the Corporation's specialist revenue protection activities centering on the provision of inspectors and transit patrol officers.

3.3.83 In 1989, the then Government introduced a transport reform program which focused on improving the utilisation of railway staff and the introduction of driver-only trams. In particular, the Government aimed to significantly change passenger behaviour from purchasing tickets within the transport system to an off-system approach which enabled the pre-purchase of scratch tickets from retail outlets. The Corporation's revenue protection activities were also expanded at that time, in response to the high level of fare evasion associated with the introduction of these reforms.

3.3.84 A further reform package was introduced by the Government in January 1993, specifically designed to reduce the long-term costs of the public transport system through the implementation of a range of initiatives extending across the whole system. In particular, the existing ticketing arrangements were considered slow, labour intensive and provided inadequate information to effectively manage the public transport system. Fare evasion, which was estimated by the Corporation at that time to cost taxpayers between \$10 million and \$30 million each year, and full-time staffing of low patronage railway stations, were also cited as major impediments to the Corporation improving its cost recovery performance.

3.3.85 Consequently, a key initiative of the reform program was the introduction of an automated ticketing system and the driver-only operation of trains and trams, which the Corporation estimated would reduce operating costs by \$47.5 million over the period January 1993 to December 1995, including an \$11 million reduction in fare evasion.

3.3.86 Although difficulties associated with the introduction of automated ticketing have delayed the realisation of gains from reduced fare evasion, the Corporation advised that at 30 June 1996 savings of \$21.6 million in relation to automated ticketing have been made, mainly as a result of the reduction in the numbers of rail station staff. In addition, the Corporation has intensified its revenue protection activities in recent years.

.....

Revenue protection strategies

3.3.87 Primary responsibility for the prevention and detection of fare evasion offences rests with the 4 business units of the Corporation, namely Met Trains, Met Tram, Met Bus and V/Line Passenger. The major fare evasion infringements relate to:

- travelling with an invalid ticket;
- purchasing a concession ticket without a valid concession entitlement;
- failing to purchase a ticket or validate a scratch ticket; and
- using a fraudulent ticket or illegally tampering with a ticket.

Met Trains

3.3.88 Following the introduction in 1989 of the scratch ticket system, 80 revenue protection officers (RPOs) were employed within the Met Trains business unit with the aim of maximising revenue from fines and providing a deterrent against fare evasion. While the operating strategy used by this unit, which focused on periodic inspections at selected stations, was considered effective in terms of increasing fine revenue, it was not considered effective in terms of adequately deterring fare evaders due to the insufficient number of RPOs. Further, from 1993 approximately 90 customer service employees were engaged by the Corporation to undertake customer-related activities, including revenue protection.

3.3.89 For the period July 1995 to September 1995, metropolitan passenger revenue fell \$1.4 million below budget expectations, with the major shortfall relating to train passenger revenue. The Met Trains business unit identified that this deterioration was partly due to an increased number of concession passenger sales and increased fare evasion due to reduced staffing at stations. Specifically, in the 3 year period to 30 June 1995, the number of station staff had been reduced by 512 in anticipation of the implementation of automated ticketing, which resulted in 25 rail stations being permanently not staffed. Over this period, it was identified that there was patronage growth in the off-peak periods and on weekends when staffing of stations and revenue protection procedures were at a minimum.

3.3.90 In response to the above difficulties, the Corporation sought to determine more effective strategies aimed at maximising passenger revenue, rather than maximising infringement revenue. As the Corporation estimated that 70 per cent of commuters arrived or departed from stations in the central business district and major suburban stations, the new strategies which concentrated on those stations included:

- random ticket checks during the weekday morning and afternoon peak periods;
- ticket checks at non-peak periods on weekdays on a rotating basis between stations;
- ticket checks at selected stations at weekends; and
- greater visibility of inspection staff at stations located near special events.

3.3.91 In addition to the above strategies, the Corporation staffed a number of previously unmanned suburban train stations.



Other modes of transport

3.3.92 Conductors have been deployed on trams to collect fare revenue and ensure that passengers carry valid tickets. In addition, random checks have been conducted by Corporation inspectors and officers on routes where a fare evasion problem had been identified. In anticipation of the implementation of automated ticketing, the Met Tram business unit has prepared formal revenue protection strategies which incorporate the provision of warnings to fare evaders, the establishment of a database to track repeat offenders and targeted inspections for all tram lines.

3.3.93 The Met Bus business unit, which earns less than 2 per cent of the Corporation's suburban passenger revenue, has primarily relied on bus drivers to ensure that passengers carry a valid ticket. These checks have been supplemented by random checks by inspectors. However, since November 1996, this strategy has been expanded, with 10 bus drivers trained to carry out revenue protection activities outside their normal hours of duty.

3.3.94 In relation to the V/Line Passenger business unit, reliance is placed on train conductors and bus drivers to ensure all passengers carry a valid ticket. Each train conductor and bus driver checks, and where necessary, issues tickets. Occasionally, offenders are issued with an infringement notice, however, V/Line management do not consider that fare evasion is a significant problem.

Estimates of fare evasion

Met Trains

3.3.95 The increased inspection activity by the Corporation in recent times is reflected in the increased number of passengers directed to purchase a ticket or to validate a scratch ticket since July 1993. The number of such directions, based on Corporation records, is detailed in Table 3.3G below.

TABLE 3.3G
DIRECTIONS TO PURCHASE OR SCRATCH TICKETS,
JULY 1993 TO FEBRUARY 1997
 ('000)

<i>Year</i>	<i>Infringement revenue</i>	<i>TINs (a)</i>	<i>Direct to scratch</i>	<i>Direct to purchase</i>
	(\$)	(no.)	(no.)	(no.)
1993-94	2 103.2	37.7	10.2	357.9
1994-95	2 419.8	36.1	20.1	430.5
1995-96	3 040.8	32.3	147.5	1 004.2
1996-97 (to Jan. 1997)	1 577.4	11.0	83.5	567.3

(a) Represents Traffic Infringement Notices.

3.3.96 The table illustrates that over one million passengers were detected by Corporation staff during 1995-96 as travelling without a valid ticket. Based on current trends, it is estimated by audit that a similar number will be detected in 1996-97.



3.3.97 Furthermore, the Corporation has conducted surveys aimed at identifying the extent of fare evasion. In particular, in the period March 1994 to March 1995, the Met Trains business unit has conducted 3 surveys of inspectorial activities, covering each train line on both weekdays and weekends. However, since March 1995, no further surveys across the entire system have been conducted by the Corporation in anticipation of the implementation of the automated ticketing system. The Corporation plans to undertake surveys on each train line before and after the automated ticketing equipment has been installed.

3.3.98 The results of the most recent cross-system survey in March 1995 indicated that the estimated annual cost of fare evasion on suburban passenger trains was approximately \$10 million. Furthermore, the surveys have consistently indicated that more than 80 per cent of offenders were not in possession of a ticket, with more than 60 per cent asserting that the station from which they had departed had not been staffed.

3.3.99 Table 3.3H compares the results of recent surveys conducted on lines utilising the automated ticketing system with a survey carried out in August 1996, prior to the installation the new system.

TABLE 3.3H
FARE EVASION ESTIMATES -
LINES USING AUTOMATED TICKETING (a)
 (per cent)

Rail line	Week ending -			
	3/8/96	14/2/97	21/2/97	28/2/97
Alamein	8	(b)	7	12
Glen Waverley	3	9	10	11

(a) Excludes concession irregularities.

(b) No survey conducted on this line.

3.3.100 Audit was advised by the Corporation that, while passenger unfamiliarity with the system has contributed to increased fare evasion, passengers have also been aware that the Corporation had initially adopted an educational and customer focused approach on these lines. In particular, the Corporation had chosen not to fine passengers identified as travelling without a valid ticket during the period in which the automated ticketing machines were being installed, and in the period until the equipment was demonstrated to operate reliably. While recognising that any change to customer habits can produce short-term revenue instability, the Corporation adopted this strategy to avoid the discord associated with the introduction of the previous scratch ticket scheme, and to ensure that the Corporation was well placed to prosecute offenders once the new system is fully implemented.



3.3.101 The Corporation had advised audit that it intends to extend revenue protection activities on lines utilising the automated ticketing system from March 1997. Under these arrangements, Corporation staff propose to commence warning passengers who do not purchase a ticket with details of such offenders recorded on a database and warning letters issued to repeat offenders. It is proposed that continual offenders will be prosecuted.

Other modes of public transport

3.3.102 Unlike the Met rail system, the most common irregularities on other modes of public transport relate to the abuse of concession entitlements.

3.3.103 Over the period June 1996 to August 1996, around 91 000 tram passengers were checked by Met Tram customer service employees to ensure they were carrying valid tickets. In 1.7 per cent of these cases, an irregularity was detected, with 58 per cent of the irregularities relating to invalid concessions and 29 per cent representing a failure to purchase a ticket. **However, costings of such irregularities were not carried out by the Corporation, with the most recent prior survey conducted in 1987.**

3.3.104 Furthermore, audit identified that no surveys had been carried out on trams on the East Burwood line since the conversion to automated ticketing which commenced in September 1996. However, it was observed that, consistent with the strategy used on trains, the Corporation's staff have not fined offending passengers but rather assisted them to better understand the new system.

3.3.105 Surveys conducted on Met buses indicate that ticket irregularities over the past 3 financial years have increased from 2.1 per cent in 1994-95 to 5.8 per cent at February 1997. The main type of detected irregularities related to passengers claiming concessions without a valid concession ticket, **however, costings of such irregularities had not been carried out by the Corporation.** Audit was advised by Corporation staff that verification of concessions was a particular problem due to the range of concession cards, the lack of photographic identification on the cards and the variety of concession entitlements. In order to address this risk, as previously outlined, 10 bus drivers have recently been trained to carry out revenue protection activities outside their normal hours of duty and all bus drivers have been briefed on the range of valid concessions available.

3.3.106 It was considered by audit that, as a matter of priority, the Corporation should re-institute system-wide surveys of fare irregularities on each mode of transport as a means of monitoring evasion and developing appropriate revenue protection strategies. In the absence of such surveys, audit was unable to determine the effectiveness of the Corporation's revenue protection strategies.



How will the automated ticketing system curb fare evasion?

3.3.107 The automated ticketing system involves the purchase and validation of tickets prior to travel. Under the proposed arrangements, passengers at 20 major Met Train stations (including all Melbourne central business district stations) will be required to activate and proceed through barriers by inserting a valid ticket. Passengers on approximately 70 per cent of all train journeys will be required to pass through a barrier at least once, providing protection against fare evasion. However, there is a continuing risk associated with concession tickets in that they may be purchased from ticket vending machines without a valid concession entitlement. To reduce this risk, the validation of these tickets at the barrier will activate a light, which will enable the monitoring of users of these tickets where barriers are manned.

3.3.108 At 200 smaller train stations, no physical barriers to entry will be installed, with reliance placed on passengers to voluntarily validate tickets. However, where such stations are manned and offences detected, passengers will be fined, as in most cases the system eliminates most excuses for not purchasing a ticket.

3.3.109 Tickets purchased on trams will be automatically validated. However, following the removal of conductors, reliance will be placed on passengers to validate pre-purchased tickets. Vending machines on trams will only accept coins and do not dispense daily tickets. This feature will encourage passengers to make off-system purchases of tickets, however, initially it may result in passenger dissatisfaction and failure to purchase a ticket.

3.3.110 On buses, tickets may be purchased from the drivers, which will be automatically validated. However, reliance will be placed on passengers to validate pre-purchased tickets, although the presence of a bus driver may provide a deterrent against evasion.

3.3.111 In order to mitigate the risks associated with fare evasion across the entire public transport system, the Corporation intends employing approximately 330 roving customer service employees, to ensure passengers carry valid tickets. The Corporation has determined this staffing level based on the projected frequency of ticket checking required throughout the system to effectively manage the extent of fare evasion.

3.3.112 **Clearly, effective revenue protection will require a level of inspection to be sustained across the system such that, on a continuing basis, the benefit from evading fares is matched by the likelihood of detection.**

Patronage levels

3.3.113 As mentioned previously, the reform package introduced by the Government in 1993 was designed to lower the long-term costs of the public transport system. The second phase of this program, which was introduced in March 1994, focused on improving service reliability and satisfying customer needs.

3.3.114 Audit conducted an analysis of system patronage levels and related revenues to assess the impact of the reform program on patronage and revenue levels. Table 3.3I illustrates the Corporation's patronage and revenue levels for Met and V/Line services, for the period July 1993 to February 1997.



TABLE 3.3I
PATRONAGE AND RELATED REVENUE LEVELS, JULY 1993 TO FEBRUARY 1997 (a)
 (million)

	1993-94	1994-95	1995-96	July 1995 to February 1996	July 1996 to February 1997
Patronage (nos.)	225.1	226.7	236.5	154.6	159.7
Revenue (\$)	219.7	228.5	238.9	156.4	162.0
Average revenue per million patrons (\$)	0.98	1.01	1.01	1.01	1.01

(a) Relates to Met and V/Line services.

3.3.115 The audit analysis revealed that patronage and related revenue levels have increased steadily each year since 1993-94, with the Corporation attributing this increase to:

- improved economic conditions, particularly within the central business district;
- improved timetables and punctuality;
- upgraded station facilities, including security and car parking; and
- effectiveness of revenue protection measures.

3.3.116 Preliminary data indicates that the current level of patronage will be sustained in the 1996-97 financial year.

3.3.117 **Audit commends the Corporation on the progress achieved over the period. The challenge it now faces is to maintain this positive trend, particularly in an environment of organisational and system changes.**

Automated ticketing system

3.3.118 A key initiative of the transport reform program is the proposed progressive introduction of an automated ticketing system, which is required to meet the Government's commitment to maintaining the multi-mode ticket system. My previous Reports commented on the agreements entered into by the Public Transport Corporation in May 1994 for the installation by a private sector consortium of automated ticketing dispensers and validation machines on all metropolitan trams, buses and railway stations. The consortium is responsible for the supply, installation, testing, commissioning, maintenance and management of the ticketing system.

3.3.119 Key milestones that were to be met by the consortium under the automated ticketing system service agreement comprised:

- prototypes of ticket validation and vending machines to be delivered to the Corporation by December 1994;
- automated ticketing system to be tested within a defined geographical area by February 1995; and
- the system to be fully commissioned across the metropolitan transport system by February 1996.



3.3.120 As indicated in my previous Reports to the Parliament, due to the inability of the consortium to meet these milestones, the Government in April 1995 commenced negotiations with the consortium to re-schedule the delivery of the prototype machines and the introduction of the automated ticketing system. Consequently, in September 1995, the Corporation and the consortium entered into a collateral agreement which suspended certain rights of both parties under the service agreement and allowed the consortium to concentrate on delivering a fully commissioned pilot system by November 1996. The suspended rights are to be re-instated on completion of the collateral agreement or if the agreement is terminated prior to its completion.

3.3.121 The collateral agreement contains a number of specific milestones relating to the completion of the system, including:

- Formal qualification testing, planned for completion by May 1996 and aimed at achieving verification by the consortium's system development contractors that the system software, hardware and other components meet the Corporation's specified requirements. The consortium's contractors issued certificates of acceptance for all sub-systems in April and May 1996. Although the Corporation was not required to issue a certificate of acceptance, it considered that the requirements of the formal qualification testing were not satisfied until February 1997;
- First article acceptance testing, planned for completion by July 1996 and aimed at ensuring that the individual sub-systems delivered by the consortium meet the functional specifications when installed. The Corporation issued qualified acceptance certificates in relation to the bus sub-system, and the rail and tram sub-systems in June and July 1996, respectively. The Corporation removed these qualifications in February 1997; and
- Roll-out acceptance testing, planned for completion by September 1996, including the installation of the pilot system and the successful completion of system acceptance testing. Acceptance certificates in relation to this phase were issued by the Corporation in March 1997.

3.3.122 At the date of preparation of this Report, the consortium had installed automated ticketing equipment, including ticket validating and vending machines, on 24 rail stations, 25 bus routes and one tram route. At February 1997, the Corporation had collected revenue totalling \$2.5 million from automated ticketing machines.

3.3.123 Following the issue of roll-out acceptance testing certificates, the Corporation and the consortium are required to agree that the system is ready for commissioning testing, after which the Corporation has 4 weeks to undertake this testing. During this period, the Corporation must be satisfied that the automated ticketing equipment achieves the performance measures stipulated in the collateral and service agreements. It is anticipated by the Corporation that completion of testing will be achieved by the end of April 1997. The Corporation is required to issue acceptance certificates depending on the results of these tests, with roll-out of the automated ticketing equipment to proceed if the Corporation is satisfied with the results of the commissioning testing. However, if the Corporation is not satisfied with the results of the testing, it may commence procedures to terminate the contract.



3.3.124 It is envisaged by the Corporation that the ticketing system will be progressively implemented on the remainder of the transport system over a 12 month period, more than 2 years later than originally planned.

3.3.125 At the date of preparation of this Report, the Corporation had not made any payments to the consortium. Under the service agreement, the Corporation is not obliged to make any payments until the consortium can demonstrate to the Corporation that it has successfully installed and commissioned the equipment.

3.3.126 The consortium has lodged a number of notices of delays and contract variations in relation to which the Corporation has not admitted responsibility. While the Corporation has the right to receive compensation for late commissioning of the system, the parties in March 1997 entered into a supplemental agreement, under which the consortium and the Corporation have agreed to forgo claims for compensation, except in respect to variations arising from changes in functional specifications and increases in operating costs arising from those variations.

□ **RESPONSE** provided by Chief Executive, Public Transport Corporation

The Corporation concurs with the observations and views expressed in the Report by the Victorian Auditor-General's Office following its audit of matters relating to PTC revenue protection measures, patronage levels and the automated ticketing system.

Over the last 3 years, the Corporation has increased its revenue protection activities and has continually modified its protection strategies and measures. This has been partly in response to the delayed introduction of the automated ticketing system and the reduction in station staffing levels in particular over this period. The effectiveness of the various revenue protection measures and increased activities has been evident in increased revenues being collected both at the fare box and from infringements.

The automated ticketing system, expected to be progressively implemented over the next 12 months, will require a significant change on the part of passengers' ticket purchasing behaviour. Following a period of customer familiarity with the new system, the Corporation will re-assess and modify its revenue protection measures to ensure they remain effective under the fully operational automated ticketing system. A further 200 customer service employees will also be employed over the next 12 months to provide roving revenue protection on a permanent basis across the 3 transport modes.





**CONTRACTING-OUT OF
THE MELBOURNE TO WARRNAMBOOL RAIL PASSENGER SERVICE**

3.3.127 The Auditor-General’s *Report on Ministerial Portfolios, May 1995* commented on the contracting-out of certain country passenger services previously provided in-house by the Public Transport Corporation, which represented one of a range of reforms announced by the Government in January 1993.

3.3.128 In that Report, audit commented on the results of an analysis of the evaluation undertaken by the Corporation to support the contracting-out of the Warrnambool and Cobram services. This analysis concluded that, as all relevant records relating to the decision to contract-out these services had either not been retained or were not able to be produced for examination, **audit was not in a position to form a conclusive view on the cost-effectiveness of the decision to privately operate the 2 train services.**

3.3.129 In response to this audit conclusion, the former Department of Transport indicated that it would evaluate the contracts against original cost estimates after they had been in operation for a reasonable period of time.

3.3.130 As mentioned above, one of the 2 services contracted-out was the Melbourne to Warrnambool passenger rail service, which transferred the operation of this service to the private sector in September 1993. Audit conducted a detailed review of the process followed in the contracting-out of the Melbourne to Warrnambool service and the outcomes achieved from the newly established arrangements.

Selection of contractor

3.3.131 An invitation to tender for a number of services, including the Melbourne to Warrnambool service, was advertised by the Corporation in January 1993, with a closing date of February 1993.

3.3.132 The then Minister for Public Transport in March 1993 released details of an agreement reached between the Government and transport unions relating to public transport reforms, a component of which related to the continued provision of rail passenger services on at least 6 country lines, of which a maximum of 2 could be privately operated.

3.3.133 Following an evaluation undertaken by consultants appointed by the Corporation of the tenders submitted for the private operation of the rail services and the Corporation’s acceptance of the consultants’ evaluation, in April 1993 the then Minister for Public Transport announced the government decision regarding the future structure of country passenger rail services. The decision involved 2 corridors, namely the Warrnambool and Cobram Services, to be operated by private operators.

3.3.134 Following the above government announcement, contract negotiations with the preferred tenderer to operate the Melbourne to Warrnambool service, the Victorian Railway Company Pty Ltd (trading as West Coast Railway), commenced in May 1993 with a proposed implementation date of August 1993.

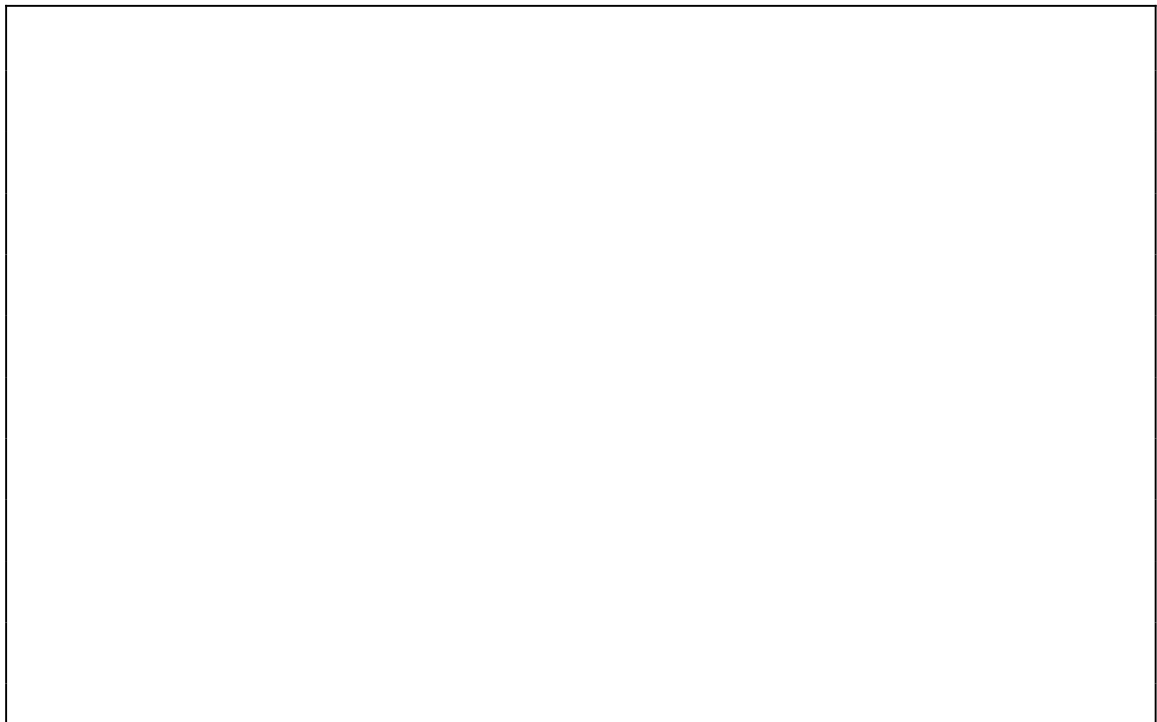
3.3.135 However, as a result of delays in finalising the contract, the Company and the Corporation entered into an interim agreement to enable the Company to commence



operating the passenger service from September 1993. Under the terms of the interim agreement:

- all locomotives, carriages and drivers necessary to operate the service were to be provided by the Corporation with the associated expenses reimbursed by the operator;
- conductors and signalling staff were to be provided by the operator;
- the Winchelsea, Colac, Camperdown, Terang and Warrnambool stations and an administration office at the Geelong station were to be leased by the operator from the Corporation and staffed by the operator; and
- track and signalling infrastructure were to be provided by the Corporation and the associated expenses reimbursed by the operator.

3.3.136 At the time of the commencement of the service, the then Minister for Public Transport announced that this privatisation would achieve annual savings to the State of \$3 million.



Train used by West Coast Railways.

.....

Contractual arrangements

3.3.137 The principal arrangements entered into for the operation of the rail service are set out in the following documents:

- a Service Agreement, between the operator and the Department of Infrastructure (formerly the Department of Transport); and
- a Support Services Agreement, between the operator and the Corporation which requires the provision of services such as infrastructure maintenance by the Corporation.

3.3.138 In addition, the Corporation's V/Line Freight business has entered into an agreement with the operator in relation to the provision of certain services by both parties. Further, another division within the Corporation provides miscellaneous services to the operator under an informal arrangement.

3.3.139 **Although the Company took over the operations of the rail service in September 1993, it was not until September 1994 that the Service Agreement was signed between the operator and the former Department of Transport, which became responsible for administering the contracts for the provision of country rail passenger services as a result of an amendment to the *Transport Act 1993*.**

3.3.140 **Furthermore, it was not until 24 April 1997 that both the Support Services Agreement and the agreement between the Corporation's V/Line Freight business and the operator were signed.**

3.3.141 The main features of the 2 key agreements, namely the Service Agreement and the Support Services Agreement, are as follows:

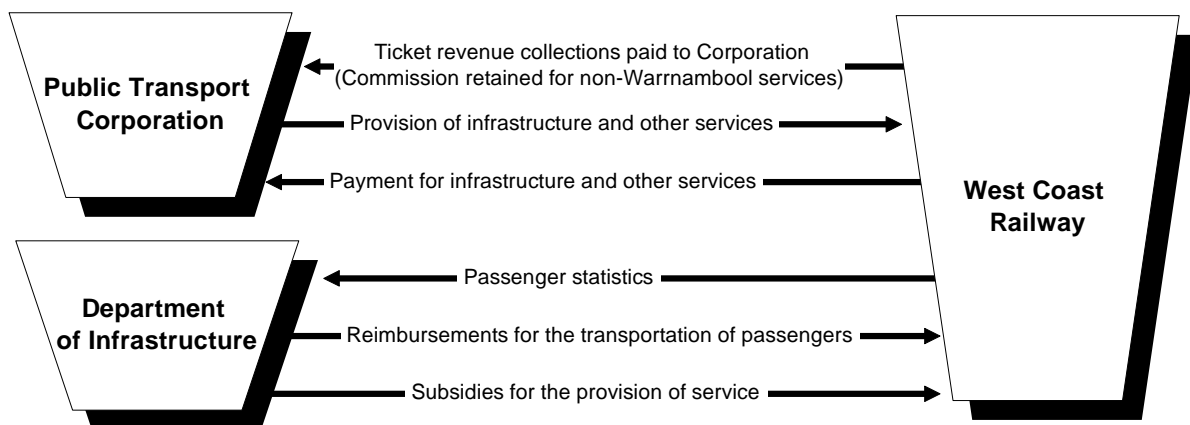
- the operator to provide passenger services between Melbourne and Warrnambool;
- the operator to collect fares based on rates determined by the Minister for Transport;
- all fare revenue collected by the operator to be paid to the Corporation excluding a commission retained by the operator on fares collected for travel not on the Melbourne to Warrnambool line;
- passenger statistics to be provided by the operator to the Department of Infrastructure which form the basis of reimbursement by the Department for the transportation of passengers;
- the Corporation to provide certain services and facilities to the operator and the operator to reimburse the Corporation for related costs incurred; and
- the Department to pay the operator a subsidy in relation to the provision of the service.



3.3.142 However, these arrangements have evolved since the commencement of the service by the private operator. In particular, as envisaged at the commencement of the service, the operator has now purchased its own rolling stock, thus reducing the extent of locomotive and carriage hire costs from the Corporation. These assets, which were surplus to the Corporation's requirements, were sold to the operator at negotiated prices. In addition, the operator now leases the Ballarat East locomotive depot at an annual market fee of \$12 000 and undertakes most of the maintenance on its own rolling stock.

3.3.143 The key relationships between the respective parties resulting from the Service Agreement and the Support Services Agreement are outlined in Chart 3.3J.

**CHART 3.3J
KEY RELATIONSHIPS RESULTING FROM CONTRACTUAL ARRANGEMENTS**



Service Agreement

3.3.144 As previously indicated, the Service Agreement establishes the basis for the provision of the rail service by the operator. The audit review indicated a number of issues relating to the operation of the Agreement.

Reimbursement of infrastructure costs

3.3.145 Under the Agreement, the operator is required to reimburse the Corporation for infrastructure maintenance undertaken based on a set rate per journey, subject to annual indexation.

3.3.146 For the 1995-96 financial year, \$7.3 million was expended by the Corporation in relation to infrastructure maintenance on the Melbourne to Warrnambool line, of which \$1.5 million was attributable to the operator and the remainder to other users. This amount was reimbursed by the operator to the Corporation. However, **the costs required to be reimbursed by the operator did not include non-cash items such as corporate overheads and depreciation associated with the maintenance activities, which were estimated by the Corporation at \$200 000 a year.**



3.3.147 As the level of these maintenance related reimbursements by the operator were higher than the amount originally determined in the tendering process and advised to tender participants, the Department has been **reimbursing the operator approximately \$1 million a year** to offset the additional costs. The tender process only envisaged an amount of \$512 000 for infrastructure maintenance costs which were to be borne by the operator running the service. However, due to a change in the methodology in allocating maintenance costs between passenger and freight services by the Corporation, the amount was found to have been underestimated.

Reimbursement of ticketing system costs

3.3.148 The operator is charged for use of the Corporation's ticketing system. As this cost was not originally included in the tender documentation provided to the operator, the Department agreed that an **annual amount of \$52 000 be reimbursed to the operator** to cover costs charged by the Corporation for the use of the system.

Relief for fuel cost increases

3.3.149 As a result of diesel fuel cost increases imposed by the Commonwealth Government from 1 July 1995, which increased the cost per litre of fuel by over 33 per cent, the operator sought financial relief from the Department. **Although the Department was not obligated under the Service Agreement to reimburse such increases, it nevertheless agreed to increase the level of the annual subsidy paid to the operator by \$122 000 to offset the additional costs associated with fuel price increases.**

Further financial assistance to operator

3.3.150 In June 1995, the operator requested that **the Department make available funding assistance of \$300 000** to overcome a short-term liquidity problem caused by the acquisition and upgrading of the operator's rolling stock, and unexpected costs associated with hiring rolling stock which was originally expected to cease in October 1995 but was extended until December 1996. In response, the Department agreed to prepay revenue and infrastructure reimbursements of \$300 000 to the operator. The debt, which was offset by the reduction of subsequent revenue reimbursement to the operator, **did not attract an interest charge.**

3.3.151 In addition, the operator in May 1996 applied to the Department for compensation of \$1.2 million relating to costs incurred to gain safety accreditation, which had not been identified during the tender process. At the date of preparation of this Report, the Department was in the process of evaluating the application.

Support Services Agreement

3.3.152 A review of the Support Services Agreement, which relates to the provision of defined services by the Corporation to the operator, identified the following matters in relation to its operation.



Delay in formalising the Agreement

3.3.153 As previously outlined in this Report, the operator commenced the provision of the rail services to Warrnambool in September 1993. **However, it was not until 24 April 1997, some 3½ years after the commencement of the service, that the Corporation and the operator signed the Support Services Agreement.** The delay in signing the agreement was due to the need to resolve certain issues, including those relating to insurance and indemnity clauses and penalty interest provisions in connection with the late remittance of passenger revenue collections to the Corporation.

3.3.154 The delay in formalising the agreement had the potential to disadvantage the Corporation and ultimately the State in the event that disputes arose between the relevant parties.

Lease of station facilities

3.3.155 The Agreement requires the operator to enter into leases for the stations it occupies and to pay rentals for the use of those properties. However, audit found that **the leases had not been signed as agreement had not been reached as to the assignment of responsibility for the maintenance of station buildings.**

3.3.156 Current negotiations between the parties in relation to these issues deal with payment of maintenance costs. The operator did not pay rent for the first 2 years due to the disagreement over the leases, but has now paid the outstanding rents in full. In relation to the maintenance of the station buildings, the operator has contended that there was an expectation when tendering for the service that only nominal rent would be paid on the leases and that maintenance of these assets would be undertaken by the Corporation.

Delays in forwarding passenger revenue to the Corporation

3.3.157 Under the Agreement the operator is required to pay all passenger revenue collected to the Corporation on a monthly basis, but no later than 14 days after the end of each period. **However, correspondence from the Corporation to the operator indicates that the operator is at times not complying with this requirement.**

Delays in other payments by the operator

3.3.158 While invoices raised by the Corporation are required to be paid by the operator under the Agreement no later than 14 days after receipt, correspondence from the Corporation to the operator indicates that this requirement is at times not being met. In addition, on a number of occasions the operator has deducted certain disputed amounts when paying invoices, with such deductions totalling \$320 000 over the period December 1994 to March 1996. While the Agreement provides that penalty interest may be charged in such cases, to date the Corporation has not levied penalty interest.



Monitoring of service delivery

3.3.159 To encourage the provision of timely services under the Service Agreement, the operator may be penalised for cancellations or late services. These penalties apply if, for any month:

- less than 99 per cent of all scheduled services operate; and
- less than 95 per cent of services are delivered within 10 minutes of the specified time.

3.3.160 If the above events occur, the next payment to the operator is to be reduced by 5 per cent each month until service levels are restored. Table 3.3K outlines service delivery and punctuality data relating to the operator as provided by the Department for the last 3 financial years.

TABLE 3.3K
SERVICE DELIVERY AND PUNCTUALITY
(per cent)

<i>Period</i>	<i>Service delivery</i>		<i>Punctuality</i>	
	<i>Target</i>	<i>Actual</i>	<i>Target</i>	<i>Actual</i>
1994-95	99	100	95	88.5
1995-96	99	100	95	84.4
1996-97 (to Feb. 1997)	99	100	95	89.5

3.3.161 The table indicates that reliability of service delivery has been excellent, however, punctuality remains below the established target levels since the contracting-out of the service.

3.3.162 Notwithstanding the ability of the Department to impose a penalty on the operator in relation to the failure to achieve the punctuality targets, **the Department has indicated that it has not been in a position to enforce the penalties** for the following reasons:

- the Warrnambool line is one of the last unwelded tracks in Victoria and is subject to ongoing track repair; and
- the delays are often due to the actions of the Corporation which owns and maintains the track.

3.3.163 Audit was advised that, at monthly meetings with the operator, service quality is discussed and the operator has been advised that punctuality improvements are required.

Patronage levels

3.3.164 Audit conducted an analysis of patronage levels and related revenues, based on information supplied by the Department. Table 3.3L illustrates the relevant details since the 1993-94 financial year.

**TABLE 3.3L
PATRONAGE LEVELS AND RELATED REVENUE**

<i>Period</i>	<i>Patronage</i> (boarding nos.)	<i>Revenue</i> (\$m)
1993-94 (a)	279 418	3.0
1994-95	288 448	3.1
1995-96	287 897	3.1
1996-97 (to Feb. 1997)	203 407	2.2

(a) Includes 3 months of service operations by V/Line Passenger prior to contracting-out.

3.3.165 The analysis shows a 3 per cent improvement in patronage for the period 1993-94 to 1995-96. This compares with an increase in V/Line Passenger patronage of 2.2 per cent in relation to the Melbourne to Bairnsdale service, a comparable service to the Warrnambool line.

3.3.166 Notwithstanding the small increase in patronage levels outlined above, the revenue from the service has remained relatively stable. The Department has advised audit that the reason for the relatively stable income level is the wide use of concessional travel on the line.

Payments to operator for providing the service

3.3.167 Since the inception of the arrangement, the Department has paid \$20.3 million to the operator in relation to the provision of rail services as show in Table 3.3M.

**TABLE 3.3M
PAYMENTS TO OPERATOR, SEPTEMBER 1993 TO FEBRUARY 1997
(\$million)**

<i>Period</i>	<i>Passenger reimbursements</i>	<i>Subsidies</i>	<i>Total</i>
Sept. 1993 to June 1994	3.6	0.7	4.3
1994-95	4.8	0.9	5.7
1995-96	4.9	1.1	6.0
1996-97 (to Feb. 1997)	3.5	0.8	4.3
Total	16.8	3.5	20.3

3.3.168 The above table indicates that payments to the operator have increased by 5 per cent over the 2 complete financial years under the contracting-out arrangements, i.e. 1994-95 to 1995-96.

3.3.169 As indicated earlier in this Report, at the launch of the new service it was indicated that the arrangement would result in annual savings to the State of \$3 million. However, **the Department had not determined the extent of actual savings, if any, that have been achieved from the arrangement.**



3.3.170 In my *Report on Ministerial Portfolios, May 1995*, the Department indicated that it would evaluate the contracting-out arrangements after a period of time. However, at the date of preparation of this Report, **the Department has not performed a post-implementation review of this arrangement or the contracting-out of the Melbourne to Cobram service, which commenced around the same time. Accordingly, there is a possibility that the experiences gained from these arrangements may not be factored into future privatisation proposals.**

□ *RESPONSE provided by Secretary, Department of Infrastructure*

Reimbursement of infrastructure costs

Similar adjustments to infrastructure maintenance subsidies were applied on the same basis to all rail passenger service operators in Victoria including V/Line Passenger, Australian National, State Rail Authority of NSW and Hoys. The total cost of subsidies for infrastructure maintenance did not change - while costs allocated to rail passenger businesses increased, costs allocated to the PTC freight business (V/Line Freight) decreased by the same amount.

Reimbursement of ticketing system costs

The Report again does not make the point that West Coast Railways was treated in exactly the same way as other rail passenger operators.

Relief for fuel cost increases

The 33 per cent fuel increase imposed by the Commonwealth Government from 1 July 1995 applied to locomotive fuel used by all Victorian operators.

The Report fails to indicate that the Victorian Government funded the PTC and both contracted rail operators for this cost which could not be anticipated.

Delay in formalising the Agreement

There was no risk of disadvantage to the Corporation or the State and no disadvantage occurred.

Payments to operator for providing the service

The savings to be achieved from the arrangement were calculated at \$3 million a year in 1993. The contract was let on that basis and there has been no variation made to the contract which would change that outcome.

The Department constantly monitors performance and payments made to and by West Coast Railways under the Service Agreement. All indications are that the contract is performing as originally estimated.

Experience gained through constant monitoring and scrutiny of this contract and others entered into with private public transport operators at about the same time will be invaluable in determining further privatisation proposals. To suggest that such experiences may not be factored into future privatisation proposals is simply not sustainable.





LOSSES, THEFTS AND IRREGULARITIES

3.3.171 The Public Transport Corporation has reported losses, thefts and irregularities of \$942 000 for the period July 1995 to December 1996, with the major types of incidents relating to theft of equipment and wilful damage to buildings and equipment.

3.3.172 The major incidents during this period included:

- Forced entry into Pascoe Vale Railway Station in May 1996 where offenders stole tickets with a value of \$63 500. Police are still investigating the case;
- A fire deliberately started in the passenger waiting area at Werribee Railway Station in September 1996. The Corporation has estimated costs of \$60 000 to repair the damage. Police are still investigating this case;
- A break-in at Traralgon Railway Station in September 1996 where offenders stole tickets worth approximately \$54 000, cash and cheques in excess of \$10 000 and equipment and caused associated damage of \$9 000. The case currently remains unsolved;
- Forced entry into the Thomastown Railway Station in July 1995 where offenders stole tickets with a value of approximately \$292 000. Police recovered the tickets, but the case is still subject to police investigation; and
- Unauthorised tampering with railway track points resulting in the derailment of freight wagons and damage to the railway track in May 1996. Initial estimates of the damage were placed at \$100 000. Police are still investigating this case.

3.3.173 In addition, the Corporation incurred costs of more than \$4.2 million during the period July 1995 to December 1996 mostly associated with repairing broken windows, removing graffiti and claims for lost or damaged freight.



URBAN LAND AUTHORITY

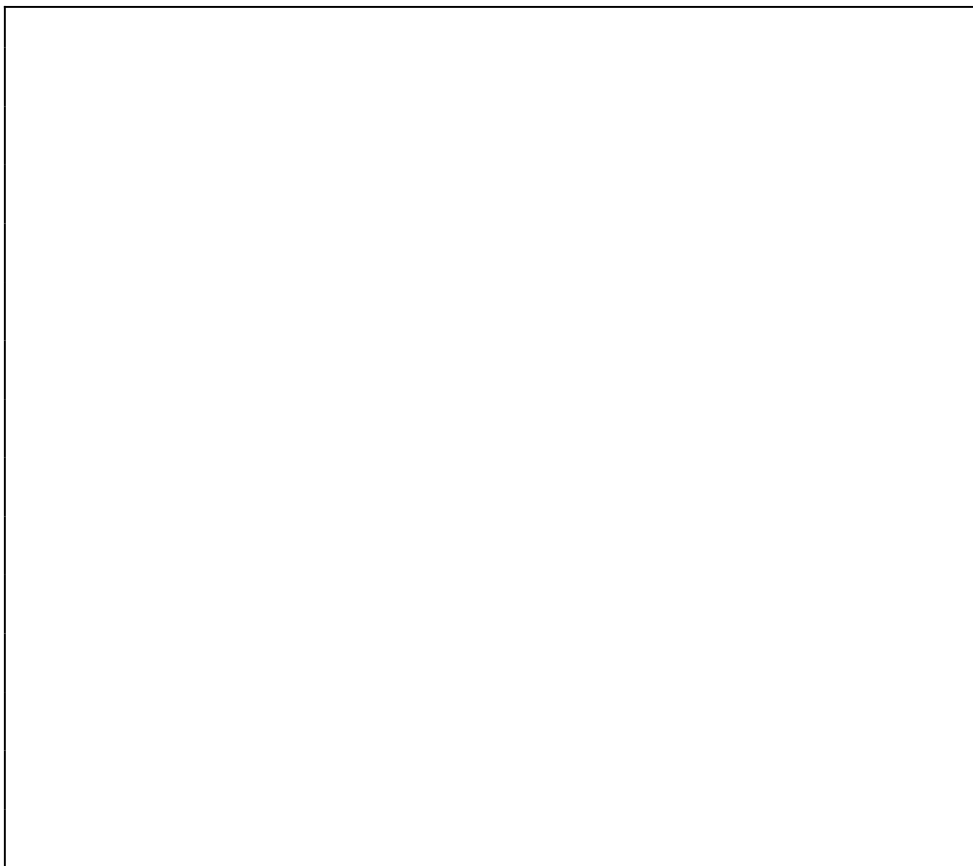
PURCHASE OF PAINTING FROM PROJECT DEVELOPMENT FEE

3.3.174 In January 1993, the then Minister for Planning agreed to a request from the then Minister for Major Projects for the former Department of Planning and Development to assume the responsibility for overseeing the Willsmere hospital site development, situated in the Melbourne suburb of Kew. However, as the Department was not in a position to undertake such work, the project was formally allocated to the Urban Land Authority.

3.3.175 In the course of establishing the project, it became necessary for the Authority to appoint a new project developer to assume responsibility for the project as the original developer was experiencing financial difficulties and was in the process of liquidation.

3.3.176 In March 1993, the Authority entered into an agreement with the new developer for the site development. The Authority's intention at that time was for the new developer to substantially retain the same obligations as those that applied to the previous developer. Under the terms of the agreement, the developer was required to lodge an amount of \$2.5 million in a bank account in the joint names of the Authority and the developer, out of which historic works undertaken at the Willsmere hospital site would be financed. The developer was also required to pay to the Authority an additional amount of \$235 000 as a *consent fee*, representing a "non-returnable bond or surety contribution". The Minister directed that this later contribution be held by the Authority and be applied towards the future renovation of a historic building or for other heritage purposes. Audit was advised that, in relation to this matter, the Authority essentially acted as an agent of the Minister with the contribution to be held in trust for use at the Minister's discretion.

3.3.177 Upon completion of the Willsmere project, in November 1995, the Minister obtained consent from the developer to apply the \$235 000 contribution towards the purchase of a historically significant painting. The Minister in turn directed the Authority to pay this sum to the National Gallery of Victoria for the purchase of a painting and the Gallery subsequently utilised the funds to assist with the purchase of a Tom Roberts painting entitled *A Mountain Muster*.



Tom Roberts born Great Britain 1856, arrived Australia 1869, died 1931
A mountain muster 1897-1920s
oil on canvas
133.0 x 153.3 cm
Purchased with the assistance of Central Equity Limited and Westfield Holdings, and through The Art Foundation of Victoria with the assistance of The Joe White Bequest, Governor, 1995
National Gallery of Victoria, Melbourne

3.3.178 Under the provisions of the *Urban Land Authority Act 1979*, the Authority is subject to the directions and control of the Minister in relation to the rights, duties and powers imposed upon the Authority under the Act. However, in relation to the transactions associated with the receipt and payment of the above contribution of \$235 000, it was difficult to establish a direct link with the specific powers of the Authority, which mainly relate to the purchase and sub-division of land and the provision of associated infrastructure.

□ *RESPONSE* provided by Chief Executive Officer, Urban Land Authority

In this matter, the Urban Land Authority (ULA) essentially acted in the capacity of an agent for the Minister, which falls within the powers of the ULA Act, in order to facilitate the Willsmere development and to handle associated transactions. In this context, the ULA was not involved in decisions concerning the ultimate use of the consent fee. It is acknowledged that the accounting treatment of the consent fee, when it was received, should have made it clear that the money was being held for the Minister. Instructions have now been issued to the ULA Accounts Department concerning appropriate identification of any receipts of this nature.

**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

LOCAL GOVERNMENT

<i>Ministerial Portfolios, May 1996, p. 156.</i>	Councils to regularly review all leasing arrangements, especially where peppercorn rentals apply.	Councils are progressively reviewing the form and content of their leasing arrangements, including the revision of rentals.
	Councils need to be aware of the extent of implicit subsidies provided where commercial rentals are not charged.	Refer to above comments.

URBAN LAND AUTHORITY

<i>Ministerial Portfolios, May 1996, pp. 170-1.</i>	The lower than expected level of lot sales at the Lynbrook estate, situated at Lyndhurst, south-east of Melbourne, resulted in a deficit of \$284 000 being incurred on the project in the 1994-95 financial year.	The estate has continued to perform below expectations, with a deficit of \$183 000 incurred in 1995-96 and a projected deficit of \$67 000 for 1996-97.
		The major reason for the deficits was the need to undertake certain initial works such as roads realignment and landscaping. The Authority is still anticipating that, once all initial costs have been recouped, the estate will make a positive return.

<i>Ministerial Portfolios, May 1996, pp. 171-2.</i>	As the work undertaken by the Authority in certain areas is similar in nature to that performed by other government agencies, scope may exist for some rationalisation with potential for cost savings and more effective use of available expertise.	During 1996, the role of the Authority was subjected to a review commissioned by the Office of State Owned Enterprises Cabinet Committee. The Committee, while noting co-operation was occurring, identified areas where there was an overlap and a lack of clarity between government real estate entities and departments, and considered that opportunities for rationalisation of functions may be identified through a review of the operations and management of all government real estate activities.
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MELBOURNE CITY LINK AUTHORITY

<i>Ministerial Portfolios, May 1996, p. 139.</i>	Need to disclose the nature and extent of the State's obligations and commitments relating to the Melbourne City Link in the Authority's financial statements and the Government's Statement of Financial Operations, in order to facilitate full accountability to the Parliament and taxpayers.	The State's obligations and commitments were adequately disclosed as at 30 June 1996.
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NO ACTION TAKEN

PUBLIC TRANSPORT CORPORATION

<i>Ministerial Portfolios, May 1989, p. 236.</i>	The adequacy and quality of disclosure within the financial reports of the transport authorities is inadequate as financing costs related to centralised debt are not included.	Position unchanged. Finance costs are reported centrally by the Government.
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**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Department of Infrastructure	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	9 Oct. 1996	11 Oct. 1996
PLANNING AND LOCAL GOVERNMENT				
Architects Registration Board of Victoria	30 June 1996	" "	8 Oct. 1996	8 Oct. 1996
Building Control Commission	30 June 1996	" "	19 Sept. 1996	20 Sept. 1996
City of Melbourne Superannuation Fund	Period 1 July 1995 to 1 Nov. 1995	29 Feb. <i>Financial Management Act 1994</i> s.46.	30 Aug. 1996	3 Sept. 1996 (a)
Docklands Authority	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> s.46.	15 Oct. 1996	17 Oct. 1996
Heritage Council	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
Loddon-Campaspie Regional Planning Authority	Period 1 Oct. 1995 to 1 July 1996	" "	17 April 1997	17 April 1997 (b)
Melbourne City Link Authority	30 June 1996	" "	24 Oct. 1996	24 Oct. 1996
Plumbers, Gasfitters and Drainers Registration Board	30 June 1996	" "	12 Sept. 1996	12 Sept. 1996
Urban Land Authority	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
ROADS AND PORTS				
Marine Board of Victoria	30 June 1996	" "	21 Oct. 1996	25 Oct. 1996
Roads Corporation	30 June 1996	" "	17 Oct. 1996	18 Oct. 1996
TRANSPORT				
Public Transport Corporation	30 June 1996	" "	6 Sept. 1996	11 Sept. 1996
LOCAL GOVERNMENT				
Alpine Shire Council	30 June 1996	30 Sept. <i>Local Government Act 1989</i> , s.126.	24 Oct. 1996	6 Nov. 1996
Ararat Rural City Council	30 June 1996	" "	9 Sept. 1996	12 Sept. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Minister for Planning and Local Government</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
LOCAL GOVERNMENT - <i>continued</i>				
Ballarat City Council	30 June 1996	30 Sept. <i>Local Government Act 1989, s.126.</i>	24 Sept. 1996	26 Sept. 1996
Banyule City Council	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
Bass Coast Shire Council	30 June 1996	" "	5 Dec. 1996	9 Dec. 1996
Baw Baw Shire Council	30 June 1996	" "	18 Sept. 1996	25 Sept. 1996
Bayside City Council	30 June 1996	" "	16 Oct. 1996	17 Oct. 1996
Boroondara City Council	30 June 1996	" "	14 Oct. 1996	15 Oct. 1996
Brimbank City Council	30 June 1996	" "	18 Dec. 1996	18 Dec. 1996 (c)
Buloke Shire Council	30 June 1996	" "	13 Mar. 1997	13 Mar. 1997
Campaspe Shire Council	30 June 1996	" "	29 Oct. 1996	19 Nov. 1996
Cardinia Shire Council	30 June 1996	" "	28 Aug. 1996	11 Sept. 1996
Casey City Council	30 June 1996	" "	9 Sept. 1996	27 Sept. 1996
Central Goldfields Shire Council	30 June 1996	" "	8 Oct. 1996	14 Oct. 1996
CityWide Service Solutions Pty Ltd	30 June 1996	" "	17 Sept. 1996	18 Sept. 1996
Colac-Otway Shire Council	30 June 1996	" "	30 Aug. 1996	30 Sept. 1996
Corangamite Shire Council	30 June 1996	" "	24 Sept. 1996	7 Oct. 1996
Corangamite Regional Library Corporation	30 June 1996	" "	30 Aug. 1996	4 Oct. 1996
Darebin City Council	30 June 1996	" "	19 Oct. 1996	24 Oct. 1996
Delatite Shire Council	30 June 1996	" "	30 Sept. 1996	18 Nov. 1996
East Gippsland Shire Council	30 June 1996	" "	23 Sept. 1996	28 Oct. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Minister for Planning and Local Government</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
LOCAL GOVERNMENT - continued				
Frankston City Council	30 June 1996	30 Sept. <i>Local Government Act 1989</i> , s.126.	17 Sept. 1996	19 Sept. 1996
Gannawarra Shire Council	30 June 1996	" "	13 Aug. 1996	5 Sept. 1996
Glen Eira City Council	30 June 1996	" "	25 Sept. 1996	27 Sept. 1996
Glenelg Shire Council	30 June 1996	" "	30 Sept. 1996	3 Oct. 1996
Glenelg Regional Library Corporation	30 June 1996	" "	25 Sept. 1996	13 Nov. 1996
Golden Plains Shire Council	30 June 1996	" "	5 Sept. 1996	26 Sept. 1996
Greater Bendigo City Council	30 June 1996	" "	15 Oct. 1996	24 Oct. 1996
Greater Dandenong City Council	30 June 1996	" "	12 Nov. 1996	13 Nov. 1996 (c)
Greater Geelong City Council	30 June 1996	" "	16 Oct. 1996	18 Oct. 1996
Greater Shepparton City Council	30 June 1996	" "	15 Oct. 1996	22 Oct. 1996
Hepburn Shire Council	30 June 1996	" "	9 Jan. 1997	14 Jan. 1997
Hindmarsh Shire Council	30 June 1996	" "	25 Sept. 1996	22 Oct. 1996
Hobsons Bay City Council	30 June 1996	" "	18 Oct. 1996	12 Nov. 1996 (c)
Horsham Rural City Council	30 June 1996	" "	24 Sept. 1996	30 Oct. 1996
Hume City Council	30 June 1996	" "	30 Oct. 1996	1 Nov. 1996 (c)
Hume-Moonee Valley Regional Library Corporation	30 June 1996	" "	11 Nov. 1996	13 Nov. 1996
Indigo Shire Council	30 June 1996	" "	21 Oct. 1996	31 Jan. 1997
Kingston City Council	30 June 1996	" "	30 Aug. 1996	30 Sept. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Minister for Planning and Local Government</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
LOCAL GOVERNMENT - continued				
Knox City Council	30 June 1996	30 Sept. <i>Local Government Act 1989, s.126.</i>	27 Sept. 1996	27 Sept. 1996
La Trobe Shire Council	30 June 1996	" "	10 Oct. 1996	24 Oct. 1996
Loddon Shire Council	30 June 1996	" "	10 Sept. 1996	10 Sept. 1996
Macedon Ranges Shire Council	30 June 1996	" "	5 Dec. 1996	11 Dec. 1996
Manningham City Council	30 June 1996	" "	3 Sept. 1996	17 Oct. 1996
Maribyrnong City Council	30 June 1996	" "	25 Sept. 1996	27 Sept. 1996
Maroondah City Council	30 June 1996	" "	13 Nov. 1996	13 Nov. 1996
Melbourne City Council	30 June 1996	" "	6 Sept. 1996	6 Sept. 1996
Melton Shire Council	30 June 1996	" "	2 Sept. 1996	16 Sept. 1996
Mildura Rural City Council	30 June 1996	" "	31 Oct. 1996	31 Oct. 1996
Mitchell Shire Council	30 June 1996	" "	21 Oct. 1996	30 Oct. 1996
Moira Shire Council	30 June 1996	" "	31 Oct. 1996	31 Oct. 1996 (c)
Monash City Council	30 June 1996	" "	2 Sept. 1996	26 Sept. 1996
Moonee Valley City Council	30 June 1996	" "	2 Sept. 1996	20 Sept. 1996
Moorabool Shire Council	30 June 1996	" "	22 Oct. 1996	31 Oct. 1996
Moreland City Council	30 June 1996	" "	26 Aug. 1996	24 Sept. 1996
Mornington Peninsula Shire Council	30 June 1996	" "	30 Aug. 1996	28 Oct. 1996
Mount Alexander Shire Council	30 June 1996	" "	12 Dec. 1996	18 Dec. 1996 (c)
Moyne Shire Council	30 June 1996	" "	30 Aug. 1996	4 Oct. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Minister for Planning and Local Government</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
LOCAL GOVERNMENT - continued				
Murrundindi Shire Council	30 June 1996	30 Sept. <i>Local Government Act 1989, s.126.</i>	21 Oct. 1996	31 Oct. 1996
Nillumbik Shire Council	30 June 1996	" "	5 Feb. 1997	6 Feb. 1997
North Central Goldfields Regional Library Corporation	30 June 1996	" "	3 Feb. 1997	4 Feb. 1997
Northern Grampians Shire Council	30 June 1996	" "	18 Dec. 1996	7 Jan. 1997
Port Phillip City Council	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
Prahran Market Pty. Ltd.	30 June 1996	" "	9 Sept. 1996	16 Sept. 1996
Pyrenees Shire Council	30 June 1996	" "	11 Sept. 1996	29 Oct. 1996
Queenscliffe Borough Council	30 June 1996	" "	18 Dec. 1996	19 Dec. 1996
South Gippsland Shire Council	30 June 1996	" "	18 Sept. 1996	23 Sept. 1996
Southern Grampians Shire Council	30 June 1996	" "	18 Sept. 1996	27 Sept. 1996
Stonnington City Council	30 June 1996	" "	9 Sept. 1996	16 Sept. 1996
Strathbogie Shire Council	30 June 1996	" "	20 Sept. 1996	30 Oct. 1996
Surf Coast Shire Council	30 June 1996	" "	26 Sept. 1996	4 Oct. 1996
Swan Hill Rural City Council	30 June 1996	" "	25 Nov. 1996	2 Dec. 1996
Towong Shire Council	30 June 1996	" "	28 Aug. 1996	27 Sept. 1996
Wangaratta Rural City Council	30 June 1996	" "	29 Aug. 1996	18 Sept. 1996
Warrnambool City Council	30 June 1996	" "	21 Oct. 1996	24 Oct. 1996
Wellington Shire Council	30 June 1996	" "	2 Oct. 1996	10 Oct. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Minister for Planning and Local Government</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
LOCAL GOVERNMENT - continued				
West Wimmera Shire Council	30 June 1996	30 Sept. <i>Local Government Act 1989, s.126.</i>	26 Sept. 1996	4 Oct. 1996
West Gippsland Regional Library Corporation	30 June 1996	" "	28 Oct. 1996	28 Oct. 1996
Whitehorse City Council	30 June 1996	" "	7 Oct. 1996	11 Oct. 1996
Whitehorse Manningham Regional Library Corporation	30 June 1996	" "	18 Dec. 1996	23 Dec. 1996
Whittlesea City Council	30 June 1996	" "	11 Oct. 1996	14 Oct. 1996
Wimmera Regional Library Corporation	30 June 1996	" "	14 Nov. 1996	15 Nov. 1996 (c)
Wodonga Rural City Council	30 June 1996	" "	29 Oct. 1996	13 Nov. 1996
Wyndham City Council	30 June 1996	" "	27 Sept. 1996	30 Sept. 1996
Yarra City Council	30 June 1996	" "	24 Sept. 1996	24 Sept. 1996
Yarra Ranges Shire Council	30 June 1996	" "	16 Oct. 1996	17 Oct. 1996
Yarra Plenty Regional Library Corporation	30 June 1996	" "	4 Oct. 1996	11 Oct. 1996
Yarra-Melbourne Regional Library Corporation	30 June 1996	" "	18 Sept. 1996	23 Sept. 1996
Yarriambiack Shire Council	30 June 1996	" "	4 Nov. 1996	18 Nov. 1996

(a) Fund abolished with members' benefits transferred to the Local Authorities Superannuation Board effective 1 November 1995.
 (b) Authority abolished 1 July 1996.
 (c) Qualified audit report issued.

Part 3.4

Justice

KEY FINDINGS

Implementation of new finance system at Country Fire Authority

- Following a tender and evaluation process, and after taking account of budgetary constraints, the CFA made a strategic decision to reject a new finance system from the preferred supplier and to implement a system that fell within its financial budget, but which would not meet its needs without additional work.
Para. 3.4.13
- System planning documentation was not prepared and approved until after key decisions had already been made, with the selected solution not fully supported by objective, detailed evaluations of the available options.
Paras 3.4.17 to 3.4.20
- There were shortcomings in the overall management of the project, including a lack of appropriately skilled staff, non-adherence to quality control standards and the late introduction of project management tools.
Paras 3.4.22 to 3.4.25
- Functional specifications were not prepared for system modules until after tenders had been called and a vendor selected.
Paras 3.4.27 to 3.4.28
- While system security requirements were specified by the CFA at the project planning stage, they were never implemented, resulting in major inadequacies in the system security.
Para. 3.4.37
- System testing did not ensure that data had been converted completely and accurately, or that the new system would operate as required.
Paras 3.4.41 to 3.4.45
- The CFA has not entered into a contract with the system vendor, covering software licensing arrangements.
Para. 3.4.47



3.4.1 The Attorney-General, the Minister for Corrections, the Minister for Fair Trading, the Minister for Police and Emergency Services and the Minister for Women's Affairs, have responsibility for operations within the Justice sector. These Ministers have collective responsibility for the Department of Justice.

3.4.2 Details of the specific ministerial responsibilities for public bodies within the Justice sector are listed in Table 3.4A. These public bodies, together with the Department of Justice, were subject to audit by the Auditor-General during the 1995-96 financial year.

**TABLE 3.4A
MINISTERIAL RESPONSIBILITIES FOR PUBLIC BODIES WITHIN THE JUSTICE SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Attorney-General	Office of the Director of Public Prosecutions Queen Victoria Women's Centre Trust Senior Master of the Supreme Court Solicitors Guarantee Fund Victoria Legal Aid Victorian Electoral Commission Victorian Financial Institutions Commission Victorian Institute of Forensic Pathology
Corrections	Victorian Prison Industries Commission
Fair Trading (a)	-
Police and Emergency Services	Country Fire Authority Metropolitan Fire Brigades Board Office of the Chief Commissioner of Police
Women's Affairs (a)	-

(a) Minister has responsibility for certain functions of the Department of Justice.

3.4.3 Comment on matters of significance arising from the audit of entities within the Justice sector is provided below. Part 4.3 of this Report comments on the results of an audit of the management and utilisation of Corporate Cards across a number of agencies including the Department of Justice.





COUNTRY FIRE AUTHORITY

IMPLEMENTATION OF FINANCE SYSTEM

3.4.4 In February 1992, external consultants appointed by the Country Fire Authority (CFA) to evaluate its computerised finance system recommended the replacement of the existing computer hardware and applications due to their obsolescence and poor functionality. At that time, the CFA had a broad strategic plan which placed the development of an effective operational management system as its first priority, the implementation of a new human resources system as its second priority, and the introduction of a new finance system was its third priority. Therefore, work on the proposed new finance system was scheduled to occur only after the other 2 system implementation projects were completed.

3.4.5 In November 1992, the CFA completed a financial system feasibility study which provided an initial assessment of the existing financial system modules.

3.4.6 Subsequently, in August 1993, at a meeting of all key users of the financial system which was held to identify the overall requirements of the new system, it was determined that the over-riding requirement for the system was to avoid establishing a second computer infrastructure to the one already established for the operational management and human resource management systems, due to the prohibitive support costs. As the CFA was spread over numerous regions, it was also considered essential that the new system was able to support a decentralised financial environment.

3.4.7 Following the development of the overall finance system requirements, in September 1993, the CFA established a listing of 40 systems that were available in the market place and the suppliers of those systems were contacted in order to determine which systems had the potential to operate on the CFA's computer infrastructure.

3.4.8 In October 1993, the CFA invited those suppliers which met its core system requirements to submit expressions of interest in the project. Following the receipt of the expressions of interest, a short list of 3 vendors was established and these parties were invited to submit tenders by November 1993. However, upon evaluation of the tenders received, it was considered that none of the vendors could provide a system which met the CFA's requirements and it was subsequently decided to investigate the products available at 4 other suppliers.

3.4.9 An information system proposal document was approved by the CFA's board in February 1994, some 15 months subsequent to the completion of the system feasibility study and 4 months subsequent to the calling of expressions of interest to replace the system. This document established that a new system was required for the following reasons:

- hardware on which the existing system resided was obsolete, making it unreliable and increasingly difficult to maintain;
- the existing system did not meet user requirements; and
- the CFA did not have an integrated fixed assets system, with details of assets recorded on spreadsheets.

3.4.10 In March 1994, following an evaluation process, a preferred supplier of the new finance system was selected. However, the selected vendor altered the price specifications for the system at the contract negotiation stage and as the CFA's financial position was severely restricted by budgetary constraints, the vendor's proposal was rejected. Another vendor who had previously been unsuccessful in the selection process was subsequently chosen by the CFA in April 1994 to provide the new financial system.

3.4.11 Since 1995, the general ledger, accounts payable, accounts receivable, inventory control and asset maintenance modules of the system have been progressively implemented. However, at the time of preparation of this Report, the system was being refined to reflect changes in the structure of the organisation.

3.4.12 An audit was carried out to evaluate the effectiveness of the processes adopted by the CFA for the development and implementation of the new financial system.

OVERALL CONCLUSION

3.4.13 Following a tender and evaluation process, and after taking account of budgetary constraints, the CFA made a strategic decision to reject a new finance system from the preferred supplier and to implement a system that fell within its financial budget, but which would not meet its needs without additional work.

3.4.14 In audit opinion, the problems encountered by the CFA in the development and implementation of the new finance system included:

- deficiencies in project planning and adherence to established plans;
- shortcomings in the overall management of the project, including a lack of appropriately skilled staff, non-adherence to quality control standards and the late introduction of project management tools;
- failure to prepare detailed functional specifications for some system modules;
- inadequacies in system security; and
- deficiencies in system testing.

3.4.15 The above problems that were encountered on this project illustrate the importance of sound project planning and management, the need for contractual arrangements for all aspects of projects, and the necessity for active involvement of users and management in the development and implementation of such projects.

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Project planning

3.4.16 To ensure that projects involving systems development and implementation are effectively established, it is important that a number of key steps are performed, including:

- determining the objectives of the project;
- identifying all feasible solutions available to meet the established objectives;
- performing a feasibility study to identify which option best meets the objectives; and
- documenting the business case which justifies the selection of the proposed solution.

3.4.17 The key objectives of the proposed new finance system were developed and outlined by the CFA in an information system proposal. That document also outlined the various options which were evaluated to determine the best solution to meet its needs. However, audit identified the following weaknesses in the evaluation process:

- Standard criteria were not developed against which each of the options were to be assessed. Accordingly, the ability of the CFA to objectively compare the available options was reduced;
- Weightings were not assigned to the various factors used to evaluate each option. Therefore, it was difficult to determine the relative importance to be assigned to the benefits and costs listed under each of the alternatives, which increased the subjectivity in the assessment process; and
- The cost of each option was not always clearly defined and the CFA was unable to provide any documentation to support cost estimates used in comparing the various options.

3.4.18 Audit acknowledges that the number of viable options were limited due to the CFA's budgetary constraints.

3.4.19 It was also identified that the information system proposal was not completed until February 1994, some 5 months after a decision had been made by the Authority to implement a purchased systems package. By that time, the CFA had researched prospective vendors, called for expressions of interest and performed detailed evaluations of available packages.

3.4.20 **Audit concluded that the preparation of documentation to support commencement of the project was tardy and recommendations made may have been biased, given that the preferred solution had already been identified and significant resources had been utilised in its implementation. Ultimately, this approach risked the waste of significant resources in implementing a solution which may not have been the most efficient and effective available option.**

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3.4.21 To ensure that future projects achieve the required results in the most efficient and effective manner, it is essential that the objectives are established, as well as the most appropriate means of achieving them, prior to their commencement. Furthermore, comparisons of the various options should involve the application of standard criteria which have been weighted according to importance, and any significant recommendations made should receive appropriate approval prior to their adoption to ensure that the decisions correspond with the business direction for the organisation.

Planning, management and control of the project

3.4.22 In May 1994, the CFA prepared a project charter which incorporated many of the elements required in planning a major project. In particular, the project charter recorded the project's business goals and objectives, the responsibilities assigned to key staff, the project resourcing requirements, and the quality management and risk management processes to be adopted.

3.4.23 However, as this document was not prepared until after the package had been selected, the responsibility for some key tasks was not specifically allocated, including the determination of system specifications, evaluation of the alternative package systems and selection of the vendor. Further areas identified where the initial project planning was deficient or where documented plans were not adhered to, included:

- While the project charter and summary reports referred to the development and existence of a detailed project plan, such a plan was never prepared. However, audit acknowledges that separate planning documents were prepared for some aspects of the project;
- Although an overall corporate budget of \$779 000 was established and monitored for the implementation of the new finance system, no documentation was maintained on budgets or methods to be employed for achieving each of the components of the project;
- Project resourcing requirements were not determined for all phases of the project, with no assessment of the time required for CFA staff to ensure the project was effectively managed;
- Some key control procedures documented in the project charter, which were designed to ensure quality control, were not implemented;
- Although some risks associated with the project were documented, not all significant risks were addressed, in particular the acquisition and retention of appropriate personnel skills; and
- While a system development methodology was intended to be utilised, some key procedures required of this methodology were not followed.



3.4.24 In addition to these deficiencies in the project planning processes, a number of significant shortcomings were identified in the overall management of the project, including:

- key finance staff involved in the project had no experience in system development and implementation, and were not provided with training to gain the skills and knowledge required to effectively perform the relevant tasks;
- quality control procedures, as developed by APT Quality Management were not adhered to; and
- effective monitoring of the progress of the project was not introduced until relatively late in the life of the project.

3.4.25 For a major information technology (IT) project to be successfully implemented it is essential that:

- its scope and boundaries for the project are clearly defined at the outset;
- accountability for the delivery of the planned business benefits and specific project deliverables is clear and reflects the required degree of partnership between the business and IT units;
- the required project skills are identified and are made available;
- all associated risks have been evaluated;
- the project plan is realistic and is designed to deliver the planned business benefits within acceptable costs, parameters and timeframes; and
- adequate project control, monitoring and reporting processes have been put in place and are followed.

Requirements analysis

3.4.26 A key part of any system development is the establishment of functional specifications which represent a complete and accurate interpretation of user needs. To effectively establish these specifications, a thorough understanding of the existing system and its problems is vital.

3.4.27 Audit identified that planning by the CFA for the system requirements analysis phase of the project was also deficient. In particular, the CFA did not prepare any planning documentation to outline the specific activities to be undertaken in this phase or to assign responsibility for the performance of the related tasks. Furthermore, there was no attempt by the CFA to monitor the in-house resourcing actually utilised in undertaking this activity.

3.4.28 While initially representatives from the IT department and all major cost centres affected by the new system were requested to assist in defining user requirements, users from the finance section did not have sufficient input into this process to ensure that the systems being assessed favourably for selection would actually meet their needs. In addition, **detailed functional specifications were not prepared in relation to the accounts receivable and purchasing modules and, in relation to the other modules, such specifications were not developed until after tenders had been called and a vendor selected.**

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3.4.29 To ensure that system selection and development decisions are soundly based, it is important that adequate processes be established to ensure the effective development of system specifications.

Tender evaluation process

3.4.30 Evaluations of vendor tenders should be conducted in accordance with clearly defined procedures and in a manner which promotes equity, with recommendations fully supported by detailed assessments against predetermined criteria.

3.4.31 The CFA initially contacted approximately 40 vendors who potentially had suitable finance systems, with 12 of these vendors subsequently invited to submit expressions of interest. Following the receipt and evaluation of expressions of interest, a short list of 3 vendors was prepared, with these parties invited to make a presentation to the CFA of the system they offered. A project team was set up to evaluate these systems and following detailed investigation it was determined that none of the 3 systems met the requirements of the CFA.

3.4.32 A further 4 systems were evaluated by the project team and it was determined that one of these packages met user requirements. However, the supplier had priced the product at \$1.25 million, which was beyond the CFA's budget and the system was rejected due to cost considerations.

3.4.33 The project team recommended to the CFA's Board that one of the previously rejected packages should be accepted at a cost of \$600 000, although the justification for its initial rejection remained valid. The reason for the system now gaining acceptance was based on a price differential of \$650 000 and the need for a new system to be implemented quickly due to failing existing hardware.

3.4.34 It is important that decisions made in the tender evaluation phase should be supported by a genuine assessment of a range of appropriate and justifiable criteria, not just price.

Design and development

3.4.35 The design phase of an IT project involves the production of design specifications documentation which describes the system data, functions, processes, sub-systems and interfaces. Security measures which ensure that the system is protected from unauthorised access and control features which ensure the integrity of application data should also be addressed at this stage. In addition, software development should be conducted in accordance with technical design specifications, and separate system development and testing environments should be established and appropriately controlled.



3.4.36 Audit identified that the CFA did not perform a business process re-engineering analysis to ensure procedures adopted for the new system would maximise efficiency. Instead, users adopted procedures which were similar to those in place for the previous system as much as possible, which reduced the scope for the organisation to gain the full benefit for resources invested in the new system. The CFA has recently implemented improvements to the business processes within the new finance system which also take account of major structural changes to the organisation.

3.4.37 Furthermore, while system security requirements had been specified in the information system proposal, including access to be assigned according to position and the need for audit trails, these were never implemented. Consequently, audit identified major inadequacies in the system security, including:

- insufficient controls to restrict users’ access to particular functions within each module;
- inadequacies in procedures for removing terminated users from the system; and
- lack of audit trails.

3.4.38 The majority of system development work performed involved converting programs so that they could run in the CFA computer environment. It was found that the cost and time required to perform this task was significantly under estimated. Examples of significant over-runs are outlined in Table 3.4B.

**TABLE 3.4B
UNDERESTIMATION OF TIME REQUIREMENT FOR
PROGRAM CONVERSIONS**

<i>System module</i>	<i>Estimated days</i>	<i>Actual days</i>	<i>Under-estimation (%)</i>
General ledger	18	66	360
Inventory control	5	32	640
Accounts payable	13	59	450

3.4.39 Under the arrangements between the CFA and the vendor, program conversion was required to be performed by the vendor. However, in July 1994, CFA resources were allocated to this task to speed up the process, including hiring of a consultant at an extra cost to the CFA of \$70 000. The vendor was not required to reimburse the CFA for the extra costs incurred and penalties were not imposed on the vendor for failing to deliver the required product within the specified time frame.

3.4.40 It is important that any estimates of resources required to complete a particular project phase be supported by reasonable assumptions. In addition, where vendors assume responsibility for modification of systems, their role should be specified in contractual documentation, including any penalties for failing to deliver.

.....

Testing

3.4.41 The preparation of a comprehensive testing strategy is critical to ensuring the effective operation of new systems. In this regard, it was found that **the CFA failed to determine, document and follow a comprehensive test strategy for the new finance system.** This was considered unnecessary by the CFA because it had been informally agreed that the system vendor would have responsibility for performing all aspects of testing, with the exception of user acceptance testing. Due to this deficiency:

- The roles and responsibilities of those involved in the testing phase were not clearly identified;
- The IT department devoted its own resources to developing test plans and commencing to perform acceptance testing on the system, which was inappropriate given that the use and ultimate ownership of the system resided with the finance area. However, it was identified that the above approach was not appropriate and an Acceptance Test Plan was subsequently developed, which assigned responsibility for acceptance testing to the user area;
- A budget was not prepared to clearly identify the required resources for carrying out all phases of testing and for monitoring progress achieved;
- Although the system vendor was to assume responsibility for performing all system testing prior to user acceptance testing, no procedures were established to ensure that the nature or extent of testing performed by the vendor was appropriate and to monitor the vendor's progress on this task; and
- Neither the IT staff or system users involved in the testing phase had any significant experience in system implementation projects. This factor was not identified as a risk by the CFA and no attempt was made to provide staff with training on how to effectively perform system testing.

3.4.42 Furthermore, when the vendor performed the testing of the converted programs, a different database environment to that operating at CFA was utilised. As this did not provide the CFA with adequate assurance that the system would work in its own environment, the CFA's IT department devoted its own resources to performing testing for the general ledger, accounts payable, accounts receivable, and inventory modules. However, this testing was deficient in the following areas:

- detailed test plans were not prepared;
- test objectives and expected results were not documented; and
- actual test results documented were often difficult to comprehend.

3.4.43 The CFA also performed user acceptance testing, which focused on testing system functionality. However, no testing was performed to assess:

- user procedures;
- security and controls;
- user and maintenance documentation;
- contingency plans;
- system performance and volume handling; and
- ability of the system to deliver planned business benefits.



3.4.44 As a result of these deficiencies, the testing was not able to provide assurance in key areas of the system, including whether:

- the system was able to support high transaction and data volumes;
- terminal response was acceptable under all conditions; and
- the system was able to run continuously over a long period with realistic load profiles.

3.4.45 Overall, testing conducted at the CFA was not adequately planned or conducted in a manner which ensured that the system would operate as required prior to its introduction, or that data had been converted completely and accurately. It should be noted that the CFA plan to undertake “end-to-end” testing once the system has been reconfigured to meet the authority’s new structure.

Implementation and system support

3.4.46 Implementation of any new system must be a well planned process, in that operating procedures must be well defined and validation procedures developed which verify the accuracy of any data converted. Furthermore, a post-implementation review should be carried out to ensure the system is operating as expected and to assess the efficiency and effectiveness of its operation.

3.4.47 The audit review identified a number of deficiencies in the implementation and support of the new finance system, including:

- While the CFA had documented checks to be performed to ensure that data had been converted to the new system completely and accurately, there is no evidence that these checks were in fact carried out;
- The arrangements with the vendor which cover, among other things, the licensing of the system, were not formalised by a consolidated contract;
- A post-implementation review had not been conducted to assess the effectiveness of the system;
- While the CFA and the vendor have signed a letter of agreement which outlines the vendor’s system support responsibilities, the agreement does not provide any consequences or remedies if the vendor fails to deliver adequate support. Also, the CFA has not required the vendor to provide contractual assurance that the product will prove to be “Year 2000 compliant”, relying on verbal assurance only;
- The CFA does not have procedures to monitor system response times or system availability on a regular basis and no targets exist for system performance; and
- User documentation has not been updated to reflect changes that the CFA have made to the standard software product, reducing its effectiveness to users.

3.4.48 It is important that the CFA addresses these deficiencies, thereby ensuring that the finance system fully meets the organisation’s operational needs.

□ **RESPONSE** provided by Chief Executive, Country Fire Authority

The CFA notes the observation that the system has been progressively implemented since 1995. However, the system has been completely reconfigured during late 1996 and early 1997 to reflect the CFA's new decentralised organisational structure.

The CFA notes the auditor's overall conclusion and acknowledges that the CFA made the decision not to proceed with the originally preferred option. The original option was selected on a range of factors including functionality and price. However, with the vendor increasing their price by in excess of \$700 000 they could no longer be considered as the CFA's preferred supplier.

In the end the CFA made the strategic decision to implement the system which met its functional requirements as good as any other available, was within its financial budget and involved risks relating to the size of the organisation and technical issues that the CFA considered could be managed.

Project planning

With regard to the development of an Information System Proposal (ISP), prior to commencing the process of replacing the finance system, the CFA had already determined an IT strategy and policies relating to all future systems. Policies included the requirement that future systems be externally outsourced and that the system operates on the CFA's existing infrastructure. Most of the finance systems initially proposed to the CFA did not meet these basic requirements.

Under these circumstances, further assessment against more detailed criteria for most of the systems offered was therefore not considered necessary.

As the process continued, it became very clear that the CFA's options for a new finance system were very limited. Options that were not available were:

- To continue on with the existing finance system. Technically and functionally it was completely superseded; and*
- To develop an in-house system. This was not an option as it was clearly against the CFA's original policy position.*

As a result, the choice devolved to essentially a choice between the originally preferred tender and the system eventually selected. However, neither product met the CFA's functional criteria 100 per cent, but there were enormous price differences between the 2 options.

The CFA notes the remaining comments in this section by the Auditor-General.

Planning, management and control of the project

The CFA notes the auditor's comments on the project charter. The CFA adopted the approach of developing a comprehensive Project Charter after approval had been given to the Information Systems Proposal. This was to ensure that the Project Charter would incorporate correctly, exactly what the project business case was and the objectives, responsibilities and resourcing requirements were.

The CFA considers that monitoring of the total costs at a high level of the projects did take place. The costs were reviewed at project level on a monthly basis.

The CFA notes the Auditor-General's comment on the preferred methodologies to be used for the planning, management and control of projects.



□ **RESPONSE** provided by Chief Executive, Country Fire Authority - *continued*

Requirements analysis

The CFA did not want to develop a new system repeating features of the old system. The problems with the old system were well known as was its limited functionality. The approach deliberately taken by the CFA was to ensure that the CFA sought alternatives that offered significantly better functionality than the old system. The new system was to meet the CFA's future systems requirements. The CFA was concerned that using the old system as a benchmark would not allow the CFA to progress.

The CFA notes the comments by the Auditor-General on this segment of the report.

Design and development

The CFA is concerned with the observation that business processes were not re-engineered. At least 2 major differences existed between the "old" system and those now achieved in the new system. These were:

- 1. The new finance system had to operate in a decentralised basis.
The new finance system had to be consistent with the decentralised approach the CFA had taken in relation to its Operational Management System and its Human Resource Information System. The previous financial system was a centralised system and information could not be electronically shared with regions and decentralised departments. The requirement of a decentralised system was an absolute policy requirement of the CFA.*
- 2. The new system had to be fundamentally structured to accommodate the recording of financial information on an accrual accounting basis.
The "old" financial system was essentially a cash-based system and would not meet this fundamental requirement.*

As a result of these 2 factors alone, the business processes involved in the new system are entirely different to those in the previous system.

The CFA notes the Auditor-General's comments in relation to security and technical risks associated with conversions.

Testing

The CFA notes the auditor's comments on the testing phase. The CFA testing concentrated on user acceptance testing. The initial test strategy was determined in conjunction with the internal auditors and deemed adequate for an "off-the-shelf" system. The converted modules were tested at CFA Headquarters on the CFA infrastructure.

As previously indicated, the CFA is currently doing "end-to-end" testing now that the system has been reconfigured to meet the CFA's new environment. It is expected that the testing will be successful and the system will be fully operational on 1 July 1997. A test strategy has been adopted for this important final phase of the project.

Implementation and system support

With regard to the proposal that a post-implementation review is done, this has not been undertaken because the system has not been completely implemented. As indicated earlier, the system has been reconfigured to reflect the new organisational structure with the implementation to be completed by 30 June.

The CFA notes the observations by the Auditor-General in relation to data conversions.



LOSSES, THEFTS AND IRREGULARITIES

3.1.49 Table 3.4C summarises particulars of losses, thefts and other irregularities, including property damage, which occurred in 1995-96, and which were reported to audit by entities within the Justice sector.

TABLE 3.4C
LOSSES, THEFTS
AND OTHER IRREGULARITIES
(**\$**)

<i>Item</i>	<i>Amount</i>
Department of Justice-	
Cash discrepancy	3 100
Property losses	144 790
Country Fire Authority-	
Losses	24 560
Theft	62 480
Victoria Police -	
Losses	50 790
Theft	1 170
Victoria Legal Aid -	
Theft	20 800



**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

DEPARTMENT OF JUSTICE

Crimes Compensation Tribunal

<p><i>Ministerial Portfolios, May 1995, pp. 157-8.</i></p>	<p>Consideration should be given to performing a review to determine whether work-related claims should also be dealt with under the Criminal Injuries Compensation Act.</p>	<p>Under section 16 of the <i>Victims of Crime Assistance Act, 1996</i> in determining whether or not to make an award or the amount of any award, the Tribunal may take into account any compensation, assistance or payments of any kind under any scheme including that managed by the Transport Accident Commission and the Victorian WorkCover Authority and that established by the Police Assistance Compensation Act.</p>
<p><i>Ministerial Portfolios, May 1995, p. 159.</i></p>	<p>The Tribunal and the Director of Public Prosecutions (DPP) have not developed procedures to recover moneys from convicted offenders.</p>	<p>Victims are able to seek compensation for pain and suffering from convicted offenders in the court where the conviction was made. Office of Asset Confiscation established in 1998 to assist in the recovery process. Working party established to develop procedures.</p>



SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED - continued

SHERIFF'S OFFICE

OFFICE OF THE CHIEF COMMISSIONER OF POLICE (OCCP)



SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS				
Department of Justice	30 June 1996	31 Oct. <i>Financial Management Act 1994, s.46.</i>	3 Oct. 1996	11 Oct. 1996
ATTORNEY-GENERAL				
Office of the Director of Public Prosecutions	30 June 1996	" "	22 Oct. 1996	24 Oct. 1996
Queen Victoria Women's Centre Trust	30 June 1996	" "	16 Oct. 1996	18 Oct. 1996
Senior Master of the Supreme Court (a)	31 Dec. 1995	<i>Supreme Court Act 1986</i>	7 Nov. 1996	15 Nov. 1996
Solicitors' Guarantee Fund	30 June 1996	31 Oct. <i>Financial Management Act 1994, s.46.</i>	16 Oct. 1996	16 Oct. 1996
Victorian Electoral Commission	30 June 1996	" "	2 Oct. 1996	3 Oct. 1996
Victorian Financial Institutions Commission	30 June 1996	" "	26 Aug. 1996	27 Aug. 1996
Victorian Institute of Forensic Pathology	30 June 1996	" "	25 Sept. 1996	8 Oct. 1996
Victoria Legal Aid	30 June 1996	" "	25 Oct. 1996	25 Oct. 1996
CORRECTIONS				
Victorian Prison Industries Commission	30 June 1996	" "	20 Sept. 1996	20 Sept. 1996
POLICE AND EMERGENCY SERVICES				
Country Fire Authority	30 June 1996	" "	6 Sept. 1996	13 Sept. 1996
Metropolitan Fire Brigades Board	30 June 1996	" "	3 Sept. 1996	3 Sept. 1996
Office of the Chief Commissioner of Police	30 June 1996	" "	19 Sept. 1996	26 Sept. 1996
INCOMPLETE AUDIT				
Senior Master of the Supreme Court	30 June 1996	<i>Supreme Court Act 1986.</i>	Audit substantially completed.	

(a) Senior Master of the Supreme Court produces financial statements which are not a statutory requirement and these statements are audited by arrangement.

Part 3.5

Natural Resources and Environment

KEY FINDINGS

Asset holdings and recognition

- While it is recognised that limitations may exist on the Department's ability to increase rental charges and at the same time satisfy community expectations, scope appears to exist to improve financial returns for some of the Department of Natural Resources and Environment's property holdings.

Paras 3.5.10 to 3.5.12

- In relation to a number of forest management areas, the Department is incurring costs to allow operators to remove native trees and wood products, with limited financial benefits accruing back to the State.

Paras 3.5.13 to 3.5.15

Management of Crown land reserves

- There is a clear need for the Department to review the current reporting framework relating to committees of management and trustees, to provide a proper functioning accountability process.

Paras 3.5.22 to 3.5.26

- The receipt and review of limited financial information once every 3 years, together with the absence of an appropriate departmental program to inspect Crown land reserves, did not ensure that the Department became aware on a timely basis of potential problems arising in committees of management.

Paras 3.5.33 to 3.5.37

- The Department had not established a formal, systematic and risk based inspection program to ensure that Crown land reserves were not mismanaged or used for other than specified purposes.

Paras 3.5.38 to 3.5.39



KEY FINDINGS - continued

Reforms of alpine resorts

- A review of the *Alpine Resorts Act*, 1983, under the competition policy principles culminated in the announcement by the Government, in March 1997, that the Commission would cease to exist at the end of October 1997 and be replaced by new alpine resort operational management arrangements.
Paras 3.5.44 to 3.5.51
- Given the sensitivity of environmental issues at alpine areas, particular attention will need to be given to the continued development of appropriate management plans and strategies to ensure the preservation of these unique areas for the benefit of future generations.
Paras 3.5.52 to 3.5.54
- A review of the Commission's asset management practices found that systems and procedures had not been developed to effectively assess the condition of infrastructure other than buildings.
Paras 3.5.55 to 3.5.56
- Future site lease agreements need to be appropriately structured to ensure the collection of appropriate site rentals at the various resorts.
Paras 3.5.57 to 3.5.62

Unaccounted water

- During the 1995-96 financial year, water loss due to inaccurate customer meters cost the retail water companies in excess of \$10 million.
Paras 3.5.77 to 3.5.83
- The retail water companies are implementing meter replacement programs to assist in the better management of water resources.
Paras 3.5.79 to 3.5.81
- Around 7 per cent of water purchased from the Melbourne Water Corporation is lost as a result of water leakages, costing the retail water companies \$7 million per annum.
Paras 3.5.84 to 3.5.90
- To assist in addressing water loss through leakage the retail water companies have recently implemented a program of accelerated infrastructure replacement.
Paras 3.5.90 to 3.5.91
- The retail water companies currently supply around 3 000 properties with 8 gegalitres of water per annum free-of-charge, as a community service. From a demand management perspective, the availability of water free-of-charge provides no incentive for users to embrace good water conservation practices.
Paras 3.5.92 to 3.5.94

3.5.1 The Minister for Agriculture and Resources and the Minister for Conservation and Land Management, have responsibility for operations within the Natural Resources and Environment sector. These Ministers have collective responsibility for the Department of Natural Resources and Environment.

3.5.2 Details of the specific ministerial responsibilities for public bodies within the Natural Resources and Environment sector are listed in Table 3.5A. These public bodies, together with the Department of Natural Resources and Environment, were subject to audit by the Auditor-General during the 1995-96 financial year.

**TABLE 3.5A
MINISTERIAL RESPONSIBILITY FOR PUBLIC BODIES
WITHIN THE NATURAL RESOURCES AND ENVIRONMENT SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Agriculture and Resources	Australian Food Industries Science Centre City West Water Ltd Daratech Pty Ltd Gippsland and Southern Rural Water Authority Goulburn Murray Rural Water Authority Melbourne Market Authority Melbourne Water Corporation Murray Valley Citrus Marketing Board Murray Valley Wine Grape Industry Development Committee Non-metropolitan water authorities (36) Northern Victorian Fresh Tomato Industry Development Committee Radius Computing Pty Ltd Renewable Energy Authority of Victoria South East Water Ltd Sunraysia Rural Water Authority Veterinary Board of Victoria Victorian Dairy Industry Authority Victorian Dried Fruits Board Victorian Institute of Marine Sciences (a) Victorian Institute of Marine Sciences Superannuation Fund (b) Victorian Meat Authority Victorian Plantations Corporation Victorian Strawberry Industry Development Committee Water Training Centre Wimmera Mallee Rural Water Authority Yarra Valley Water Ltd
Conservation and Land Management	Alpine Resorts Commission Bairnsdale Waste Management Group Bundoora Park Committee of Management (c) Environment Protection Authority Eastern Regional Waste Management Group Melbourne Parks and Waterways Mount Macedon Memorial Cross Committee of Management (d) Northern Regional Refuse Disposal Group

TABLE 3.5A
MINISTERIAL RESPONSIBILITY FOR PUBLIC BODIES
WITHIN THE NATURAL RESOURCES AND ENVIRONMENT SECTOR - continued

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Conservation and Land Management - cont.	Penguin Reserve Committee of Management Port Bellarine Committee of Management Recycling and Resource Recovery Council (e) Royal Botanic Gardens Board Shrine of Remembrance Trustees South Eastern Regional Waste Management Group State Swimming Centre Committee of Management Surveyors Board of Victoria Trust for Nature (Victoria) Waste Management Council (e) Western Regional Waste Management Group Yarra Bend Park Trust Zoological Board of Victoria Zoological Board of Victoria Superannuation Fund

- (a) Victorian Institute of Marine Sciences combined with Victorian Fisheries Research Institute to form the Marine and Freshwater Research Institute from 1 July 1996.
- (b) Ceased operations on 30 June 1990.
- (c) Ceased operations on 19 January 1996.
- (d) Ceased operations on 18 April 1995.
- (e) Ceased operations on 17 December 1996 and were combined to form Eco Recycling.

3.5.3 Comment on matters of significance arising from the audit of entities within the Natural Resources and Environment sector is provided below.

ASSET HOLDINGS AND RECOGNITION

3.5.4 The Department of Natural Resources and Environment’s property holdings include national and State parks (3.8 million hectares), commercial and non-commercial forests (3.5 million hectares) and numerous individual Crown land holdings (550 000 hectares) including Crown reserves used for public purposes. In addition, the Department is responsible for the roads, tracks, bridges, buildings and other structures located in parks and forests.

Valuation of assets

3.5.5 My previous Reports to the Parliament have commented on the Government’s commitment to improving financial reporting and asset management within the public sector. As part of this process, the Department aimed to identify and value its substantial property holdings for inclusion in its 1995-96 financial statements.



3.5.6 An audit review of the property valuation program adopted by the Department revealed that the program commenced prior to the development of appropriate departmental policies and procedures relating to asset recognition and valuation. As a result, inconsistencies arose in the accounting and valuation practices adopted across the Department and issues relating to agency responsibility for asset control were not addressed. Consequently, the valuations were not included in the Department's financial statements as they were considered to be unreliable due to:

- the valuation assumptions developed by the valuer lacking adequate support to enable independent verification;
- lack of departmental information on the intrinsic factors relating to specific environmental classes of assets; and
- the inclusion of assets not controlled by the Department.

3.5.7 At the date of preparation of this Report, the Department was in the process of developing appropriate policies and procedures for its Crown land holdings and working with its valuers to develop an appropriate valuation basis.

Surplus property holdings

3.5.8 In 1992, the Department commenced a review of its property holdings to identify surplus assets. At 30 June 1996, around 25 000 of the Department's 70 000 parcels of land, representing 90 per cent of the total land area under departmental control, had been assessed. The review has identified 10 770 surplus properties, of which 3 340 had been sold at the date of audit.

3.5.9 Factors influencing the time taken to dispose of surplus properties include obtaining Ministerial approval for sale, undertaking site surveys, revoking any applicable reservations, creating freehold title, re-zoning and negotiating with the purchaser.

Poor returns on property assets

3.5.10 The Department's current policy in relation to its property assets is to generate market returns on all properties with the exception of those used for community, agricultural or local government purposes. However, the terms and conditions of many existing leases and licenses did not have a market rental basis as they had been designed to reflect prior policy directions, such as to encourage settlement and development in many areas within the State.



3.5.11 The Department has 390 leases providing an annual return of less than \$100, and 730 miscellaneous licences providing an annual return of less than \$100. An audit examination of a sample of the properties generating a return of less than \$100, found the following 2 properties, as shown in Table 3.5B which did not generate a sufficient return.

**TABLE 3.5B
PROPERTIES GENERATING AN INSUFFICIENT RETURN**

<i>Location</i>	<i>Nature of property</i>	<i>Current rental</i>	<i>Estimated valuation (a)</i>
Brambuck Living Centre, Grampians National Park	Centre including cafe and gift shop	nil	\$1.5 million
186 Nicholson Street, Fitzroy	Land and building	\$1	\$5 million

(a) Value incorporated in departmental financial statements.

3.5.12 While it is recognised that limitations may exist regarding the Department’s ability to increase rental charges and at the same time satisfy community expectations, scope appears to exist to improve financial returns for some of the Department’s property holdings.

Commercial forests

3.5.13 The Department has responsibility for approximately 1.2 million hectares of commercial forests within Victoria which are logged on a sustainable yield basis to ensure adequate supplies of hardwood are available for future consumption. The volume of hardwood that can be logged in State forests is restricted by legislation.

3.5.14 In order to place a value on the State’s commercial forests, the Department has adopted a forest valuation model based on the present value of the predicted future cash flows for each forest management area over the next 100 years. The model is updated each financial year to reflect the actual cash flows generated from annual logging of each area.

3.5.15 Over the past 2 financial years, the Department’s cash flow calculations have shown that 3 forest management areas had negative net present values, with a further 2 areas achieving only a small positive net present value. In other words, **the Department is incurring costs to allow operators to remove native trees and wood products, with limited financial benefits accruing to the State.**

Unauthorised use of Crown land

3.5.16 Of the 70 000 Crown land parcels recorded on the Department’s land information management system, 9 873 land holdings are recorded as vacant. The Department is progressively confirming the data recorded on the system by undertaking physical inspections of each property. **This process has enabled the Department to identify a number of properties which are occupied without a lease or a licence being issued.**

□ **RESPONSE** provided by Secretary, Department of Natural Resources and Environment.

The Department does have policies in relation to property assets for market returns including agricultural and local government use of Crown land. Overall, the Department seeks to obtain market rent, which may be set on the basis of highest and best use or permitted use. The only departure from this approach is in relation to community use tenures.

In general, financial returns are affected by the following factors:

- *location - whether the land is within a city or town or is rural land;*
- *the type of land or land use, e.g. leases of swamp or reclaimed land typically return low rents; and*
- *the statutory regime, e.g. rents under surf club leases are set at nominal amounts by specific legislation.*

The 2 leases named in Table 3.5B must be put in the context of (i) providing opportunities for broader understanding of Aboriginal history and culture in Victoria and (ii) provision of health services to Melbourne's Aboriginal community.

The inspection process regarding use of Crown land has also identified parcels of land that are actually under the control of other government departments and agencies, where such control has not been formally notified to the Department.

The commercial forestry business within the Forests Service generated profits in 1994-95 and 1995-96. Although it is correct that performance in some regions should be improved, the business as a whole is not subsidising the timber industry. The Department is looking at opportunities to improve its commercial performance across the State, including in those areas identified by the Auditor-General.

MANAGEMENT OF CROWN LAND RESERVES

3.5.17 Crown land represents one of the State's most significant resources, comprising around 34 per cent of Victoria's land area, or 8 million hectares. Most of this land is within the parks and forests systems, but there are also over 7 000 Crown land reserves set aside for other public purposes.

3.5.18 The Department of Natural Resources and Environment is responsible for the management of Crown land under the provisions of the *Lands Act 1958*, the *Crown Land (Reserves) Act 1978* and the *Crown Land (Amendments) Act 1994*. However, the management of around 4 800 Crown land reserves has been delegated to committees of management, trustees and other organisations. Nevertheless, the Department has retained a strategic role by regulating the delegated management of these reserves and associated assets through the development of relevant policies and strategies, and the provision of advice and information to the Minister and the delegated managers of Crown land and associated assets, such as committees of management and trustees.



3.5.19 Committees of management comprise local municipalities and around 1 680 locally elected or nominated committees drawn from the general public which utilise Crown land reserves for various purposes including public halls and other public buildings, public parks and sports and show grounds. Trustees have also been appointed to manage Crown land reserves which have been utilised for various purposes, including cemeteries, public halls, other public buildings, public parks and churches. Other major uses of Crown land reserves by committees of management and trustees include racecourses, caravan parks and camping grounds, golf courses and bowling clubs.

3.5.20 My May 1989 *Report on Ministerial Portfolios* commented on the results of an audit review of the framework administered by the former Department of Conservation, Forests and Lands relating to the management and accountability of committees of management. The Report found that for many years there had been no systematic approach by the Department to the administration and monitoring of the delegated management of Crown land reserves. Generally, committees had been allowed to operate autonomously with the Department only becoming involved when requests for assistance were received. The Report also found that while some progress had been made by the Department to enhance its management systems and practices, there remained a need for further action to address a number of significant deficiencies in the established accountability and management arrangements. In particular, the review recommended that:

- as a matter of urgency, the value of assets under the control of committees (then estimated at \$100 million, excluding land values) be incorporated into the Department’s management information system (the LIMS system);
- the Department ensure that staff from its regional offices regularly update and review information on LIMS and conduct periodic inspections of reserves;
- committees be required to prepare, on a regular basis, a report of operations setting out objectives and progress made towards achieving those objectives; and
- consideration be given to the inclusion of an overall summary of the performance of committees in the annual report of the Department.

3.5.21 It is against this background that audit conducted a follow-up review of the accountability and management framework currently operating in relation to Crown land committees of management and trustees. The audit review did not include an examination of committees of management represented by municipal councils, or trustees of Crown land reserves utilised for cemeteries, given that the overall operations of these delegated managers are subject to specific legislative accountability frameworks.

Accountability framework

3.5.22 The *Crown Land (Reserves) Act 1978* sets out the financial accountability framework for committees of management, which includes the requirements for committees to:

- keep full and proper accounts of receipts and expenditure; and
- prepare annual statements of receipts and expenditure, the balance of cash in hand and, if a committee has been appointed on the recommendation of a trustee, a report of its operations.



3.5.23 The Act further provides that the above annual statements are to be forwarded to the Department or, in the case of committees appointed on the recommendation of a trustee, to the Minister and the relevant trustee. However, the Act does not establish any specific financial accountability requirements for trustees of Crown land reserves, although in some cases reporting obligations may be established under legislation authorising the creation of trustees.

3.5.24 To complement the legislative financial accountability framework, the Department issued a *Handbook for Committees of Management of Crown Land Reserves* in 1988 to provide members of committees with guidance on various management issues, including financial and performance reporting matters. The handbook suggests the establishment of the following financial reporting arrangements by committees, in addition to those required under the Act:

- larger committees which handle significant amounts of money or which manage considerable assets to prepare a balance sheet, a sources and applications of funds statement, and a statement of actual income and expenditure with budget comparisons;
- the books of account of all committees to be audited at least once in every 3 years, or in respect of committees which receive external grants or which have an annual turnover of more than \$10 000 to be subject to an annual audit;
- all financial reports of committees provided to the Department to be audited; and
- all committees to prepare annual performance reports which provide an assessment of achievement against established objectives.

3.5.25 Even though the above guidance has been provided, it is considered that the current overall framework is deficient in facilitating proper accountability and monitoring of committee of management operations. In particular, with the exception of a small number of committees and trustees which have been declared as separate reporting entities under the *Financial Management Act 1994* and are subject to the detailed reporting and other accountability obligations of that Act, it was concluded that:

- in relation to the more significant Crown land reserves, the statutory reporting obligations, which do not require performance related reporting and only relate to the presentation of unaudited cash-based statements, are inconsistent with modern financial and resource management accountability requirements;
- adherence to the guidance provided in the handbook on financial reporting and accountability matters was not mandatory and the handbook does not prescribe tendering procedures or require committees to seek independent expert advice when setting lease rentals or rates and charges; and
- the accountability framework does not require public reporting of committee operations to either local communities, the Parliament or the public generally.



3.5.26 Given that effective financial and performance reporting are essential features of a proper functioning accountability process, there is a clear need for the Department to review the current reporting framework relating to committees of management and trustees. As part of such a review, and in recognition of the varying nature and size of committee and trustee operations, consideration should be given to the establishment of an appropriate hierarchy of minimum accountability requirements, based on assessments of financial, conservation and operational risks associated with individual committee and trustee operations.

Departmental strategy

3.5.27 The business plan relating to the management of the Department's Crown land for the 1996-97 financial year outlines several policy directions which will significantly affect the future accountability framework of committees of management and trustees, including:

- The sale or vesting to local managers of Crown land reserves which have been assessed to be of local or regional significance, with the majority of reserves vested in municipal councils; and
- Improved monitoring of delegated managers of Crown land reserves which have been assessed to be of Statewide conservation, recreation, social or economic significance. These reserves are to be managed with a view to maximising financial returns in the context of meeting community and environmental needs.

3.5.28 The business plan indicates that the strategy is to re-define the relationship with committees of management to make them more autonomous and accountable. In particular, the plan proposes to identify and define "major" reserves by October 1996, review accountability mechanisms for major reserves and specify improvements in accountability.

3.5.29 At the time of preparation of this Report, the Department was still in the process of preparing a definition of crown land reserves that are deemed to be "major" or of "Statewide significance" to serve as the starting point for effecting accountability improvements. The timely implementation of this initiative will be important in addressing the current management deficiencies over committee and trustee operations.

Conflicts of interest

3.5.30 The handbook associated with the management of Crown land reserves issued by the Department highlights that members of committees of management may also be members of some other groups with an interest in the Crown land reserve subject to their management, but that such members must put the interest of their committees first when performing their roles as members. Further, the handbook outlines that persons conducting commercial businesses on Crown land reserves subjected to delegated management should not seek to become committee members, and that members who stand to gain financially from committee decisions should not participate in the related discussion and should abstain from voting on related issues.



3.5.31 The audit review found instances where committee or trustee memberships included significant representation from recreational organisations which used Crown land to derive their income, or persons who derived part of their income by conducting business with committees of management.

3.5.32 While it is recognised that it may not always be appropriate or possible to appoint persons completely free of any potential conflict of interest to committees, **in audit opinion, an appropriate framework should be established setting out specific requirements relating to matters pertaining to conflicts of interest, in order to ensure the maintenance of community confidence and probity in committee operations.** Such a framework should include requirements for all members of committees of management to:

- annually prepare a statement of private interests, or more often if personal circumstances substantially change;
- stand aside from any discussion or decision-making process of committees that may involve a conflict of interest, such as the setting of rates and charges and leasing arrangements; and
- ensure appropriate disclosure of all related party transactions, that is transactions between committees and its members or related parties, in the reports of such committees.

Monitoring of committee operations

Inadequate information

3.5.33 While committees of management are required by legislation to forward certain financial information each year to the Department, procedures had not been established by the Department to ensure that such information was always provided. Instead, the Department requested and accepted the provision of financial information by committees at 3 yearly intervals to coincide with the re-election of committee membership.

3.5.34 Audit considered that **the receipt and review of the limited financial information once every 3 years, together with the absence of an appropriate departmental program to inspect Crown land reserves, did not ensure that the Department became aware on a timely basis of potential problems arising in committees of management, such as insolvency and mismanagement.**

3.5.35 The 1989 audit review of committees of management recognised that the introduction by the Department of the Land Information Management System (LIMS) had established a medium for closer monitoring of committees' activities. However, an analysis of information currently held on the LIMS system indicated that:

- financial statement information had not been recorded on the system for 40 per cent of committees;
- information recorded on the system was out of date in that 50 per cent of financial statement information were over one year old while 30 per cent were over 2 years old; and
- financial statement details of only 5 trustees were recorded on the system.



3.5.36 The lack of current information on the LIMS system further highlights the low priority assigned by the Department to the efficient and effective management of committees of management. This is particularly significant when viewed in the context of the substantial public resources controlled by some committees and trustees, and the potentially significant risks they can represent for the community.

3.5.37 At the time of preparation of this Report, a revision to the LIMS system was being undertaken by the Department. However, the ability of the revised LIMS system to facilitate more effective and efficient monitoring of committees of management and trustees operations will depend on the Department's allocation of priority and resources to this area. Audit was advised that the Department's ability to resolve matters raised by audit depends, at least in part, upon its capacity to obtain or redirect the necessary resources.

Inadequate departmental inspection

3.5.38 It was found that the Department had not established a formal, systematic and risk-based inspection program to, inter alia, ensure that Crown land reserves were not being mismanaged or used for other than specified purposes. Inadequate management of Crown land reserves can potentially lead to a reduction in the heritage, conservation, public interest or social value of such land, or the misuse or waste of economic resources.

3.5.39 While the Department does conduct site visits, they are generally undertaken concurrently with other unrelated departmental activities. It is also acknowledged that some committees of management have departmental representatives on the committee, which can mitigate the frequency or need for site inspections. However, such departmental membership could be taken into account when designing a formal systematic and risk-based inspection program.

RESPONSE provided by Secretary, Department of Natural Resources and Environment.

With respect to the Accountability Framework for the Management of Crown Land Reserves, the Department recognises that consideration should be given to the establishment of minimum accountability requirements. The Department's current work on the Crown reserves system addresses 3 issues: appropriate accountability framework for different classes of delegated managers; appropriate level of autonomy in decision-making by delegated managers; and appropriate relationship between the Crown and delegated managers.

The potential for conflicts of interest to arise is acknowledged, but it would more often be a conflict between the broad public interest and a sectional community interest than between public and private interests.

In monitoring Committee operations, the Department's ongoing public land assessment program will be the vehicle for increased inspections of reserves to not only confirm public land values but also to ensure proper management.

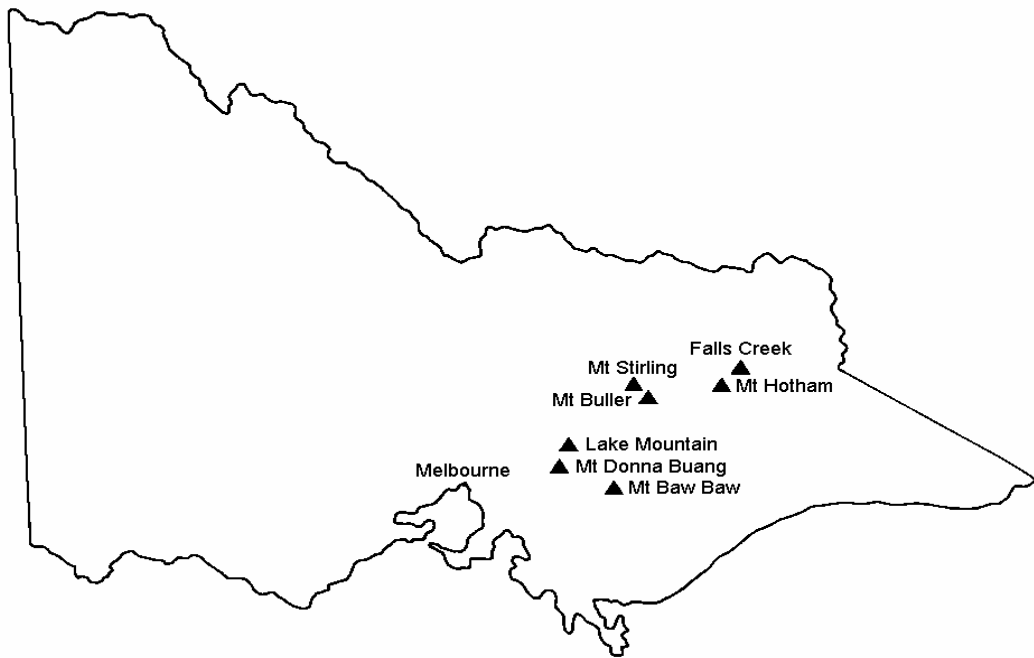




REFORM OF ALPINE RESORTS

3.5.40 Victoria's alpine resorts are located on approximately 10 815 hectares of land owned by the State and represent a significant tourist attraction, with in excess of one million visitors a year.

3.5.41 Due to their relative close proximity to Melbourne, Victoria's alpine resorts are easily accessible to a significant proportion of Australians as well as overseas visitors. The tourism and economic activity generated in the resorts is an important component of the State's economy, with approximately \$270 million expended every year by visitors to the resorts.



Location of Victorian alpine resorts.

3.5.42 Prior to the establishment of the Alpine Resorts Commission in 1984, Victorian ski resorts were managed by a number of State Government agencies which included the former Lands Department, Forests Commission, State Electricity Commission of Victoria and the National Parks Service. However, at that time, there was general agreement within the snow ski industry, environmental groups and the Government that this fragmented approach to resort administration did not provide a systematic, co-ordinated and effective resort development and marketing mechanism.

3.5.43 In order to consolidate the overall management of alpine resources under one organisation, in March 1984 the Alpine Resorts Commission was established under the *Alpine Resorts Act 1983* and took control of the 4 alpine resorts, namely Mt Buller, Mt Stirling, Falls Creek and Mt Hotham as from April 1985. The Commission assumed responsibility for Mt Baw Baw and Mt Donna Buang in 1986 and Lake Mountain in 1987. Mt Donna Buang was subsequently transferred to the Department of Natural Resources and Environment in December 1995.

Review of Commission operations

3.5.44 In 1994, the Government commissioned an extensive review of the operations and activities of the Commission. The review found that during the period 1984 to 1990, the Commission had significantly expanded its activities, however, this expansion resulted in escalating operating losses with the Commission requiring increasing levels of government subsidies.

3.5.45 The report on the results of the review outlined the following major criticisms of the Commission that had been raised by industry participants:

- lack of consultation on planning and development issues;
- the assumption of roles not considered relevant for the Commission;
- a large, bureaucratic and centralised administrative structure;
- failure to facilitate commercial development;
- inadequate knowledge of alpine resort issues;
- failure to finalise lease agreements; and
- inadequate attention to environmental issues.

3.5.46 The report also identified that in 1990 a number of initiatives were taken to address the criticisms raised by the industry including the appointment of a new Chief Executive Officer and 2 new Commissioners with alpine experience, and the establishment of the Alpine Resorts Advisory Committee. While these initiatives had improved the Commission’s performance since 1990, a number of problems remained, including:

- a lack of genuine commitment to environmental issues;
- inadequate industry consultation;
- an absence of an overall industry strategy; and
- the high costs associated with Commission operations.

3.5.47 In response to the 1994 report, the State Government appointed new Commissioners and a new Chief Executive Officer, and established new village management committees. However, their effectiveness was adversely impacted due to a number of constraints placed on their operations, including restrictions on the Commission’s ability to enter into long-term contracts or agreements, raise funding through borrowings or develop long-term plans.

3.5.48 Over the past 3 years, the Commission improved its financial viability and has implemented a number of initiatives which include:

- development of environmental policies;
- establishment of business plans and capital budgets; and
- improvement in communication with village management committees.

3.5.49 In October 1996, the Government commenced reviews of the *Alpine Resorts Act* 1983, under the competition policy principles to assess any restrictions in competition established by the legislation, together with the fee structure and financing arrangements pertaining to alpine resorts in Victoria.



3.5.50 These reviews culminated in the announcement by the Government, in March 1997, that the Commission would cease to exist at the end of October 1997 and be replaced by new alpine resort operational management arrangements. Under the new arrangements:

- The 3 major ski resorts, namely Mt Hotham, Mt Buller and Falls Creek are to be self-managed by boards of management appointed by the Government. Each resort to be responsible for its own operational management activities, subject to Government requirements for public access and sound environmental management;
- A central body, drawn from the 3 boards and the Government, to be created to deal with issues common to the resorts and of State-wide significance;
- Planning responsibilities for the alpine resorts to be transferred to the Department of Infrastructure;
- Responsibility for environmental issues to be transferred to the new resort boards of management; and
- The Government to seek expressions of interest for the management and development of the smaller resorts, namely Mt Baw Baw, Lake Mountain and Mt Stirling.

3.5.51 Prior to the government announcement of the new arrangements, audit had substantially completed an examination of the Commission's operations. This report outlines some of the issues identified, which have an ongoing impact on the operations of alpine resorts in Victoria.

Environmental management

3.5.52 As the alpine environment is rare and fragile in nature due to the number of ecosystems which exist within these areas, development activities have the potential to cause environmental damage to these ecosystems. In recognition of the need to adequately protect the alpine environment, a major objective of the Commission has been to ensure that the establishment, development, promotion and use of alpine resorts is undertaken with due regard to environmental and ecological considerations.

3.5.53 In response to environmental concerns raised in the 1994 review of the Commission's operations, an environmental policy statement was developed and formally adopted by the Commission in March 1996. Following the establishment of its environmental policy, the Commission commenced work to develop environmental management plans and undertake surveys. However, until such time as these plans and surveys are completed the actual environmental condition of alpine resorts may not be known and, consequentially, appropriate measures may not be in place to address any concerns.

3.5.54 Given the sensitivity of environmental issues at alpine areas, particular attention will need to be given to the continued development of appropriate management plans and strategies to ensure the preservation of these unique areas for the benefit of future generations.

Asset management

3.5.55 The Commission in discharging its responsibilities maintains various assets at the individual resorts. A review of its asset management practices found that **systems and procedures had not been developed to effectively assess the condition of its infrastructure other than buildings.**

3.5.56 In the absence of these systems and procedures, it will be difficult for the Commission's successor bodies to accurately estimate the condition and future maintenance expenditure required on all the assets at the various resorts, and to develop appropriate maintenance and asset replacement strategies.

Revenue collections

3.5.57 The Commission's major sources of revenue include site rentals, annual service charges, utility charges and gate entry fees.

3.5.58 A site rental agreement between the Victorian Ski Association and the State Government enables site holders to defer rent payments in certain circumstances relating to financial hardship. A review undertaken by the Commission in November 1996 found that deferred site rentals of \$482 000 and associated interest of \$17 000 had not been collected and recent legal advice indicated that recovery of these amounts was not legally enforceable. Consequently, the Commission decided not to pursue the recovery of these amounts. **It will be important that future site lease agreements are appropriately structured to ensure the collection of all amounts due from the rental of sites at the various resorts.**

3.5.59 Furthermore, considerable delays have occurred in obtaining site revaluations for the ski field areas leased by ski lift companies. Consequently, interim rentals on these areas have been based on outdated valuations, which will require future negotiations to ensure the recovery of an appropriate level of rental, taking into account the option for a market-related rent.

3.5.60 The Commission advised that the transition to a market related rent for 2 lift companies is occurring slowly as it has major implications for the economy of the resorts concerned.

3.5.61 **The existing contractual arrangements need to be reviewed, in order to determine whether the rental provisions currently resulting in low returns can be varied so that rentals can be based on current valuations.**

3.5.62 The audit review also noted that each resort levied service charges on different basis and, in determining the level of these charges, did not take account of all related costs in providing these services. **When determining the level of service charges payable at each resort, the Commission's successor bodies need to ensure all costs are taken into account to enable their full recovery.**



□ **RESPONSE** provided by Chairman, Alpine Resorts Commission

Given that the government policy directions for reform of alpine management were announced last month, I see no real value in further comment on the part of the Commission. I do note your recommendations on environmental management, asset management and revenue collection, and have no doubt that these matters will be drawn to the attention to future managing agencies.

UNACCOUNTED WATER

3.5.63 The Auditor-General’s May 1996 Report on *Ministerial Portfolios* included comment on major reforms within the Melbourne metropolitan water industry. A major component of the reform process has involved legislative changes in the form of the *Water Industry Act 1994*, which have provided for the allocation of certain of the functions of the Melbourne Water Corporation to 3 newly-established retail water companies and created Melbourne Parks and Waterways (now Parks Victoria). The retail water companies, which commenced operations in January 1995, are:

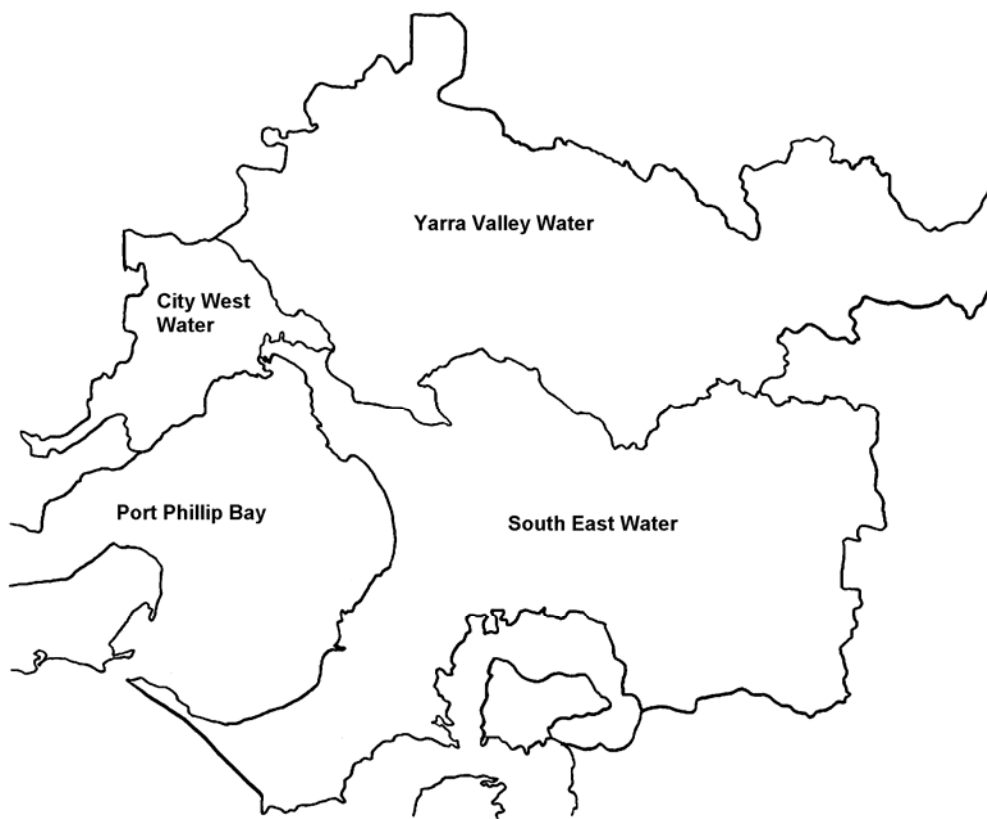
- City West Water Limited;
- Yarra Valley Water Limited; and
- South East Water Limited.

3.5.64 The remaining core business of the Corporation is to provide water and sewerage services to the 3 retail water companies on commercial terms. Pursuant to the *Water Industry Act 1994*, the 3 companies operate under a licence agreement with the Government and provide water and sewerage services throughout metropolitan Melbourne.

3.5.65 Chart 3.5C shows the retail boundaries for the water distribution systems throughout metropolitan Melbourne.



**CHART 3.5C
RETAIL BOUNDARIES**



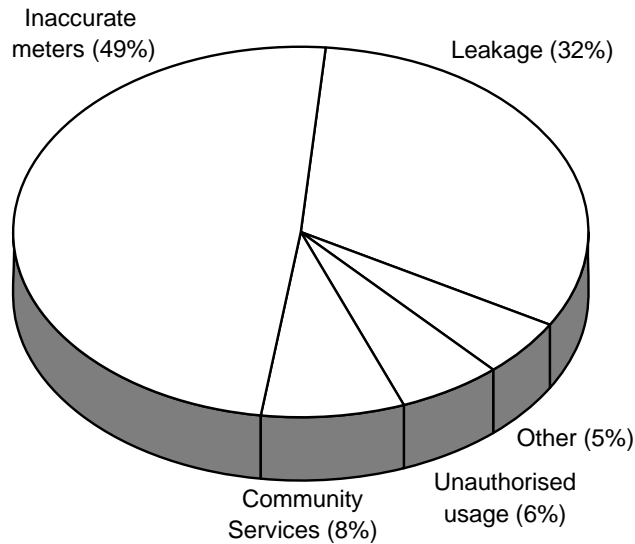
3.5.66 A common problem encountered by all water authorities is the incidence of unaccounted water, which represents the difference between bulk water acquired by the relevant authorities and that utilised by customers. While there is no standard definition for unaccounted water within the industry, audit in consultation with the Corporation and the 3 retail water companies developed the following definitions:

- *In relation to the Corporation's business, unaccounted water represents the difference between the volume of water released from the Corporation's primary storage facilities and that supplied to the retail distribution network; and*
- *In relation to the retail water companies' business, unaccounted water represents the difference between the volume of bulk water supplied by the Corporation to the water distribution system of the retail water companies and the metered consumption. The metered consumption includes water that is both billable and non-billable.*

3.5.67 The major causes for unaccounted water, from the retail water companies' perspective, as outlined in Chart 3.5D, include:

- leakage from the water distribution system;
- inaccurate water meters; and
- unmetered water provided free of charge as a community service obligation.

CHART 3.5D
MAJOR CAUSES FOR UNACCOUNTED WATER
 (per cent)



Impact of unaccounted water

3.5.68 While the Corporation's information systems are not capable of accurately calculating the amount of its unaccounted water, it estimates that the figure could be around 10 gegalitres (one gegalitre represents 1 000 million litres) or 2 per cent of water released from its storage facilities did not reach the retail distribution network during the 1995-96 financial year.

3.5.69 As the Corporation does not pay for its bulk water, and the current storage capacity of the wholesale system exceeds the annual water sales to the retail water companies, there is little direct financial incentive for the Corporation to reduce its level of unaccounted water in the short-term. However, **in the longer-term, as the growth in demand for water continues, there are potential savings available to the Corporation from improved water resource management.**

3.5.70 A study undertaken for the Corporation by an external consultant in 1992, confirmed that reductions in water losses, resulting from the implementation of leakage detection and associated repair programs, would reduce the need for new investment in storage facilities in the near future.

3.5.71 During the 1995-96 financial year, the retail water companies paid \$273 million to the Corporation for the supply of bulk water, which included a \$97.1 million variable charge, based on the volume of water consumed. **Of the 452 gegalitres of water purchased by the retail water companies in 1995-96, around 101 gegalitres (22 per cent) costing in excess of \$21 million, was unaccounted for by the companies.** The amount of unaccounted water and its cost to each of the retail water companies is outlined in Table 3.5E.

TABLE 3.5E
VOLUME AND COST OF UNACCOUNTED WATER, 1995-96

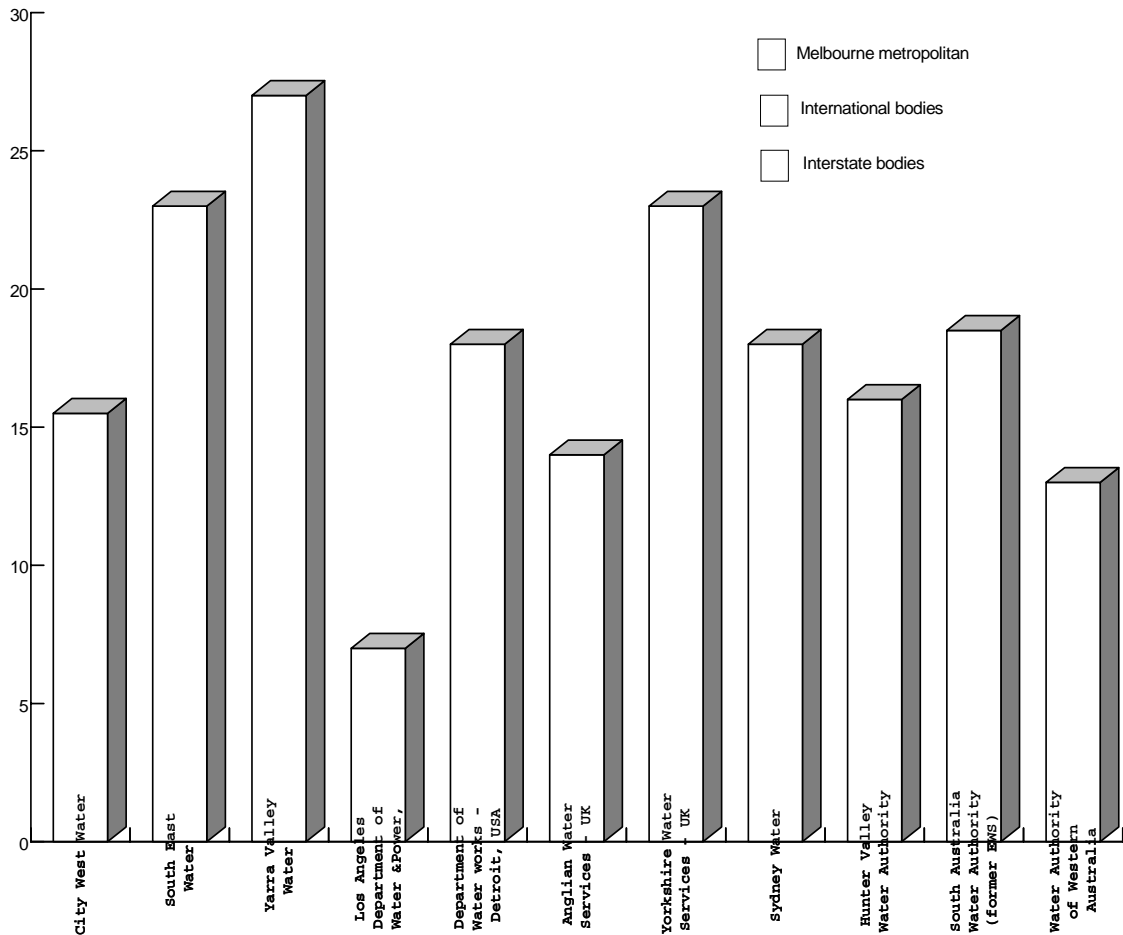
<i>Company</i>	<i>Water purchased</i>	<i>Water distributed</i>	<i>Unaccounted water</i>		
	(gigalitres)	(gigalitres)	(gigalitres)	(per cent)	(\$m)
Yarra Valley Water	194	142	52	27	11
South East Water	148	116	32	22	6
City West Water	110	93	17	15	4
Total	452	351	101	22	21

3.5.72 The retail water companies have a financial incentive to reduce the level of unaccounted water as such reductions have the potential to significantly lower their bulk water costs and increase their operating performance from a financial perspective. To this effect, following the disaggregation of the Melbourne water industry, action has been taken by the retail water companies to identify and reduce the extent of unaccounted water. In particular, Yarra Valley Water has commenced a large-scale domestic meter replacement program during 1995-96. The company has also undertaken a large-scale leakage detection pilot study and assessed 46 of its 101 distribution zones to enable targeting of leakage reduction programs. These programs represent positive initiatives aimed at addressing this problem that has existed for many years.

Comparisons with other water authorities

3.5.73 In order to assess the management of unaccounted water by the retail water companies, audit obtained comparable information on unaccounted water from 4 major water authorities within Australia and 4 authorities from overseas, as presented in Chart 3.5F. The selection of water authorities for comparative purposes was decided following consultation with the retail water companies. While audit recognises that there are limitations associated with such companies, they do provide a starting point for benchmarking purposes.

CHART 3.5F
UNACCOUNTED WATER - COMPARISONS WITH INTERSTATE
AND OVERSEAS BODIES
 (per cent)



Source: Information provided by relevant water authorities.

3.5.74 The chart shows that the average percentage of water acquired which is unaccounted by the retail water companies (22 per cent) is significantly higher than the average for the sample of other Australian water authorities (16 per cent) and for the sample of overseas water authorities (15 per cent). However, audit is cognisant that differences between the levels of unaccounted water by water authorities depend on:

- accuracy of water flow estimates;
- the relative availability and cost of bulk water; and
- relative costs associated with reducing the amount of leakage and replacing defective water meters.

3.5.75 This analysis only provides a starting point from which the performance of the Melbourne metropolitan water industry can be assessed. **However, there is a prima facie case to suggest that the current levels of unaccounted water among the retail water companies are too high and can be economically reduced.**



3.5.76 A detailed examination of the causes of unaccounted water is outlined below.

Inaccurate meters

3.5.77 Meter inaccuracy is the largest component of unaccounted water, representing around 50 gegalitres or 49 per cent of the total unaccounted water of the retail water companies. Of this quantity, the retail companies estimate that inaccurate bulk supply meters between the wholesale and retail networks could contribute 27 gegalitres, with the remaining balance (23 gegalitres) due to inaccurate customer meters. The accuracy of meters is dependent on 3 major factors, i.e age, usage and water pressure.

3.5.78 Inaccuracies in customer meters have a two-fold effect. Firstly, the retail companies are paying for water for which they generate no income and, secondly, revenue is lost where water is effectively provided free of charge to consumers. **During the 1995-96 financial year, water loss due to inaccurate customer meters cost the retail water companies in excess of \$10 million in forgone revenue.**

3.5.79 A review of customer water meters undertaken by Yarra Valley Water in 1995, disclosed that inaccurate meter readings were costing the company in excess of \$4 million in lost revenue a year. As a result of this review, the company embarked on an extensive meter replacement program which involved the replacement of around 12 000 meters in 1994-95 and 235 000 meters in 1995-96.

3.5.80 City West Water also replaced 15 000 meters in 1995-96, representing 8 per cent of all its domestic meters. The company intends to replace a further 35 000 meters in 1996-97 and another 80 000 meters over the next four years. Further, South East Water replaced 50 000 domestic water meters in 1995-96 and intends to replace a further 30 000 in 1996-97.

3.5.81 The audit review of the customer meter operations also disclosed that:

- Two of the retail water companies have an aged domestic meter population, with almost 50 per cent of domestic meters greater than 10 years old, which increases the risk of water measurement errors;
- Meters used primarily for industrial properties have not been subject to planned replacement programs at certain retail companies and, until recently, have not been tested for accuracy. Recent testing by Yarra Valley Water has indicated that the accuracy of these meters has diminished over time relative to their usage and were under-registering the volume of water consumed;
- A meter replacement program carried out by Yarra Valley Water revealed that the replacement of 52 meters on 27 large properties increased their measurement accuracy by approximately 5 to 10 per cent; and
- Many meters used primarily for industrial properties are also oversized, leading to under-registration of water flows.



3.5.82 Furthermore, based on estimates determined by the retail water companies, inaccurate bulk supply water meters between the wholesale and retail networks could be responsible for up to 27 gegalitres of unaccounted water, costing the companies around \$5.5 million a year. However, Melbourne Water Corporation is of the view that unaccounted water resulting from inaccurate bulk supply water meters would be considerably less than this volume with their investigations indicating that the uncertainty band associated with bulk meters is approximately +/- 11 gegalitres.

3.5.83 With potential revenues in excess of \$10 million available from the replacement of faulty customer water meters, there is considerable scope for the retail water companies to generate benefits from continuing with their meter replacement programs.

Water leakages

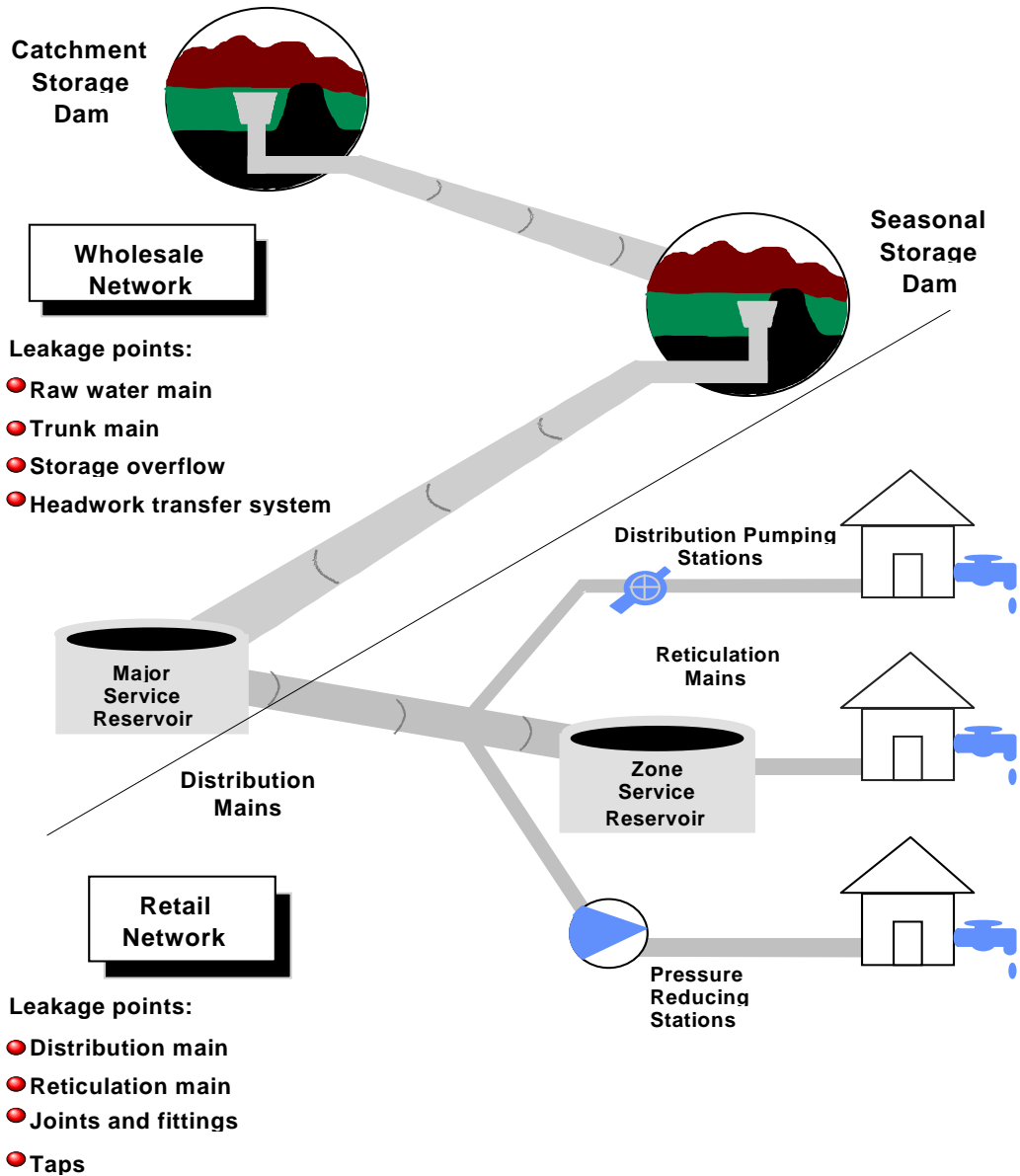
3.5.84 As illustrated in Chart 3.5F, water lost to the metropolitan distribution system through leakage represents 32 per cent of unaccounted water. **Based on information provided by the retail water companies, around 7 per cent or 33 gegalitres of water purchased from the Corporation is lost as a result of water leakages, costing the retail water companies around \$7 million a year.**

3.5.85 A comparison with selected interstate and overseas water authorities revealed that the best performing water authorities had reduced leakage levels to around 4 to 6 per cent of water purchased.

3.5.86 While South East Water advised that its leakage rate was only 2.3 per cent, Yarra Valley Water and City West Water advised that their leakage rates were 10 per cent and 7 per cent, respectively. However, in relation to South East Water, audit identified that its estimates were only based on limited system testing.

3.5.87 Chart 3.5G illustrates the types of leakage and where the leakages may occur in the water supply network.

**CHART 3.5G
LEAKAGE POINTS IN METROPOLITAN WATER SUPPLY NETWORK**



3.5.88 Water leakage is influenced by factors such as ground conditions, water pressure, and the age and structural condition of the overall water distribution system and can result from burst water mains, and leaking pipes and fire hydrants.



Emergency repairs to a water main.

3.5.89 A review of the management of this issue indicated that:

- all 3 retail companies have either completed or commenced work on the development of a leakage control policy and strategy;
- cost savings could be achieved by increasing the level of preventative maintenance on the distribution system;
- none of the retail water companies have formally determined the cost of replacing leaking water supply infrastructure; and
- a cost-benefit analysis had not been undertaken to determine the optimum economic level of leakage, i.e. the point where the cost of water lost equates with the cost of detection, location and repair.

3.5.90 To enable the effective management of water loss through leakages, the retail water companies need to:

- **finalise the development of their leakage control strategies;**
- **establish adequate systems and procedures to identify where leaks are occurring;**
- **place greater emphasis on preventative maintenance; and**
- **determine an acceptable economic level of leakage, using appropriate cost-benefit analyses.**

3.5.91 It is pleasing to report that all 3 retail water companies have recently implemented a program of accelerated infrastructure replacement in order to address some of their more significant leakage problems. Furthermore, the Corporation and the retail companies have commenced the development of industry benchmarks, performance indicators and targets, which will enable them to assess the level of unaccounted water within their distribution systems.

Community service obligations

3.5.92 In accordance with the provisions of the *Water Industry Act 1994*, the retail water companies currently supply around 3 000 properties with 8 gegalitres of water a year free of charge, as a community service. Under this arrangement, properties supplied include government schools, railway stations, prisons, police stations, public reserves and public toilets, with a number of these properties representing significant users of water. In addition, water is supplied free of charge to a number of other Government facilities, including the Royal Botanic Gardens, the Melbourne Zoo and Albert Park. **Audit estimated that the cost to the retail water companies of providing this water was in excess of \$3 million in the 1995-96 financial year.**

3.5.93 A major objective of the Government in reforming the Melbourne metropolitan water industry was to separate the community service function of parks and waterways from commercial activities. **However, the current arrangement, whereby ratepayers effectively finance the provision of water to certain entities free of charge, is inconsistent with this objective and the user-pays principle embodied in the water industry pricing structure. Furthermore, from a demand management perspective, the availability of water free of charge provides no incentive for users to embrace good water conservation practices.**

3.5.94 In its November 1991 *Report on the Cost of Community Service Obligations*, the Parliament’s Economic and Budget Review Committee recommended to the Government that community service obligations should be funded by the Consolidated Fund, as direct funding of these services was considered to be the best means for their accountability. **The adoption of such a recommendation would improve the transparency relating to costs associated with the provision of community services.**

□ RESPONSE provided by Managing Director, Melbourne Water

In the section “Impact of unaccounted water”, in the second paragraph it is stated that “there is little direct financial incentive for the Corporation to reduce its level of unaccounted water in the short-term”. When the context and the tone of the Report are taken into account, one interpretation of this statement is that Melbourne Water:

- *does not care about unaccounted water; and*
- *is not active in reducing unaccounted water.*

The statement does not recognise:

- *The strength of the commercial relationship between Melbourne Water and the retail companies. There is continuous pressure on Melbourne Water from the retail companies to prove that Melbourne Water is doing everything within its power to reduce loss of water from its system;*
- *Melbourne Water’s philosophy and associated practise that are aimed at maintaining assets in good condition to minimise leakage and quickly attending to any leaks to minimise the impacts of water loss. An example of this philosophy is the cathodic protection program where sacrificial anodes are installed to protect water mains from perforations;*

- *In the 1995-96 financial year Melbourne Water spent approximately \$1.6 million on the cathodic protection program and \$6 million replacing mains which exhibited an unsatisfactory level of leakage; and*
- *Melbourne Water's legal obligation to effectively manage water resources for greater Melbourne over both the short and long-term.*

I would also like to refer to an editorial point. This section of the Report also refers to a study undertaken by "an external consultant in 1992" which "confirmed that reductions in water losses, resulting from the implementation of leakage detection and associated repair programs, would reduce the need for new investment in storage facilities in the near future". It is Melbourne Water's understanding that the report indicated is the "Newton Langford Report". This report focuses on the detection and repair of leakage within what is now the retail water supply system, not Melbourne Water's current system.

The positioning of this statement could imply that leak detection and repair is largely a Melbourne Water issue whereas it is incumbent on all the water companies operating with metropolitan Melbourne to manage leakage effectively.

Accuracy of bulk meters

While Melbourne Water undertakes a regular program of electronic calibration of its meters there is currently no agreed method of validating the overall performance of bulk meters as all previous testing methods have proven unreliable.

Individual bulk supply meters have the potential to either over or under-register.

Although in individual cases there is a strong possibility that individual meters may be reading high or low, at this stage there is no evidence to indicate if bulk supply meters, in total, are over or under-reading. Hence, no reliable estimates can be made as to the impact on unaccounted water. Given the lack of evidence to suggest that meters are biased to continually over-read, it is difficult to see how the value of 27GL pa of unaccounted water attributed to inaccuracies in bulk meters can be supported.

As indicated in Melbourne Water's response to the audit questionnaire, Melbourne Water considers that the uncertainty band associated with bulk meters is approximately +/- 11GL pa. Further, if meters on aggregate under-read, this will mask the true level of unaccounted water within the retailer systems and not contribute to unaccounted water as is indicated in the Report.

The possibility that meters may be under-reading does not appear to have been considered in the Report.

Melbourne Water place considerable effort into resolving billing and bulk meter related issues and in 1996-97 will spend approximately \$1.2 million on the purchase of new bulk meters to improve the billing process.

Further, in order to provide greater confidence on the accuracy and performance of bulk billing meters Melbourne Water, in conjunction with the retail companies has instituted, a project to validate the accuracy of bulk billing meters to current industry standards. Should this project discover any billing meter has an accuracy outside acceptable industry standards, the meter will be adjusted, upgraded or replaced as agreed between Melbourne Water and the retail companies.



□ **RESPONSE** provided by Managing Director, Yarra Valley Water Limited

The structural reform within the Melbourne water industry has provided significant financial incentive for Yarra Valley Water to account for and conserve water within its system. Yarra Valley Water has adopted a proactive stance and implemented a range of programs designed to reduce unaccounted water and leakage. These include programs such as:

- *Customer meter replacement program - 97 per cent of all meters are now less than 10 years of age and continual review will ensure that all meters are maintained within economic accuracy levels;*
- *Revision of bulk metering - The method of calculating bulk water purchased from Melbourne Water includes estimates and are subject to meter errors that tend to overcharge Yarra Valley Water. In the year examined by the Auditor-General (1995-96) Yarra Valley Water notified Melbourne Water of required adjustments that have the potential to reduce unaccounted water for Yarra Valley Water by an estimated 7 per cent with a relative increase for the other retailers;*

Yarra Valley Water has achieved some success in realising these improvements and is confident these issues will be resolved during 1996-97;

- *Leakage management - extensive leakage surveys covering 46 of the company's 101 water supply zones have been completed along with a detailed leakage pilot study to identify the benefits and costs of leakage management and develop best practice leak detection and repair; and*
- *Unauthorised usage - development of policies and surveillance and education programs to reduce the incidence of unauthorised usage.*

Yarra Valley Water is committed to ensuring that water is accurately accounted for from the wholesaler, via the retailer, to the customer and unaccounted water and leakage is reduced to an economic level.

The comparison of the company with that of its competitors, interstate and overseas water bodies is misleading to the reader. The chart can vary for the Melbourne-based retail companies depending on bulk water metering errors and bulk water consumption. (Refer to above.)

The other comparative organisations are vertically integrated water bodies whereas the Melbourne water industry is unique in that it operates in a wholesaler/retailer environment.

The definition of unaccounted water and the differences in the infrastructure and operations of overseas water bodies including factors such as the low number of metered properties in the United Kingdom (approximately 10 per cent) and the USA measuring unaccounted water as leakage only (all other usage is metered), makes it difficult to draw any definitive conclusions from the comparison.

Since commencement of the company operations, Yarra Valley Water has doubled its investment in water main renewals to improve customer service and reduce maintenance costs. Leakage is not the primary driver of this program but some minor reduction is achieved.

The company supports the comments made with respect to Community Service Obligations.

□ **RESPONSE** provided by Chairman, City West Water

The Report was read with interest, and City West Water is pleased to note that its efforts to reduce unaccounted water are reflecting favourably in its ranking against the averages recorded for other Australian and overseas water authorities (City West Water's 15 per cent result against an average Australian result of 16 per cent and overseas result of 15 per cent).

However, few of the initiatives that have contributed to this result have been detailed in the Report. In fact, given that the Report focuses on and makes recommendations relating to the Melbourne metropolitan water industry in general, it appears that many of the initiatives included, list the activities of principally one of the Melbourne retailers being Yarra Valley Water.

City West Water has undertaken a number of initiatives which are outlined below.

As regards the company's industrial customer segment, evaluations have been made of water meters of City West Water's top 200 industrial customers, which are by far the company's highest water users and greatest source of revenue.

Other City West Water initiatives that relate less to meter inaccuracy, but more so to capturing identified points of leakage include the:

- metering of all unmetered properties;*
- provision of metered stand pipes to meter previously unaccounted water used at hydrants; and*
- metering of usage at all fire services installed since November 1995.*

City West Water acknowledges that unaccounted water is an area of the company's business the requires ongoing and dedicated attention. It is desirable that the Report provide a balance overview of the activities being undertaken by each of the Melbourne metropolitan water retailers so that it presents a true reflection of each authority's commitment to managing unaccounted water losses.

□ **RESPONSE** provided by Managing Director, South East Water Limited

South East Water is extremely concerned that the Report is open to damaging misinterpretation, particularly in respect of the statement in paragraph 3.5.71. This paragraph states that "101 gegalitres (22 per cent) costing in excess of \$21 million, was unaccounted for by the companies". The uninformed reader could interpret this to mean that 22 per cent of water is wasted.

South East Water is aware that water loss does occur within the water distribution system. However, losses are approximately 10 per cent after allowing for the volume of water used for parks and gardens, operational activities, council street cleaning, fire fighting services and inaccuracies in the bulk supply meters.



□ *RESPONSE provided by Managing Director, South East Water Limited - continued*

Further, South East Water has commenced a number of programs specifically aimed at reducing the level of true unaccounted for water. References to these initiatives were not made in your Report. These include:

- Persuing with Melbourne Water the calibration of bulk supply meters which have been reading high;*
- The development of a planned replacement program for industrial water meters where the replacement provides an adequate return on investment;*
- Increasing capital expenditure on water main renewals by threefold, particularly to reduce the number of leakages/bursts in high risk inner city areas;*
- The completion of night flow analysis of 52 of its 84 distribution zones to determine zones of relatively high base flows for targeting of leakage reduction programs. A pilot program has commenced in one of the targeted zones; and*
- Development of informative and educational brochures on efficient water usage, including savings available through fixing leaking taps and cisterns.*

Furthermore, South East Water has doubts about figures provided in respect of comparative information relating to international water companies. A majority of services in the UK are unmetered and therefore by definition, would represent a significant proportion of “unaccounted water”.

We believe that the water companies in the UK and USA do not provide free water to the community, as is the case in Melbourne. This anomaly is also distorting the comparison.

We also understand that according to the 1995-96 report by OFWAT, the UK water regulator, on average, 29 percent of water supplied to the distribution system is lost through leakage.

Unaccounted water is not “the difference between the bulk water acquired by the relevant authorities and that utilised by customers”. “Utilised” should be “metered water recorded at customer premises”. Unmetered water utilised by customers is included in accounted for water.

To appropriately represent the sources of unaccounted for water it is appropriate to separate wholesale meters from customer meters.

Industrial meters within South East Water’s boundary are subject to a planned replacement program. South East Water evaluates each industrial meter and replaces those that provide an adequate return on investment.





LOSSES, THEFTS AND IRREGULARITIES

3.5.95 Table 3.5H summarises particulars of losses, thefts and irregularities which occurred in 1995-96 and which were reported to audit by entities within the Natural Resources and the Environment sector.

**TABLE 3.5H
LOSSES, THEFTS
AND IRREGULARITIES
(\$)**

<i>Item</i>	<i>Amount</i>
Barwon Regional Water Authority Thefts	61 870
Melbourne Water Corporation - Equipment and property damage	64 450
Environment Protection Authority - Equipment and property damage	3 530
Victorian Plantations Corporation - Thefts	1 040

3.5.96 In addition, during April 1997, an attempt was made to defraud the Goulburn-Murray Rural Water Authority of \$973 000. Fortunately, the attempt was discovered by Authority staff and the Melbourne CIB are currently investigating the attempted fraud.



**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENT

<i>Ministerial Portfolios, May 1997. p. 156</i>	While it is recognised that limitations may exist on the Department's ability to increase rental charges and at the same time satisfy community expectations, scope appears to exist to improve financial returns for some of the Department of Natural Resources and Environment's property holdings.	The Department now charges full commercial rental wherever possible on all properties with only a minority of immaterial exceptions. The exceptions are where rent charges cannot be changed as they have been set as conditions on long-term leases or have been traditionally set for community reasons.
<i>Ministerial Portfolios, May 1997. p. 156</i>	In relation to a number of forest management areas, the Department is incurring costs to allow operators to remove native trees and wood products, with limited financial benefits accruing back to the State.	Situation unchanged
<i>Ministerial Portfolios, May 1997. p. 160</i>	There is a clear need for the Department to review the current reporting framework relating to committees of management and trustees, to provide a proper functioning accountability process.	A consultant has been employed in this area to review a sample of the larger committees and report back in the relationship to the Department and the potential for more accountability.
<i>Ministerial Portfolios, May 1997. p. 161</i>	The receipt and review of limited financial information once every 3 years, together with the absence of an appropriate departmental program to inspect Crown land reserves, did not ensure that Department became aware on a timely basis of potential problems arising in committees of management.	Departmental policy is to make site visits at least once every 3 years and inspections have commenced.
<i>Ministerial Portfolios, May 1997. p. 162</i>	The Department had not established a formal, systematic and risk-based inspection program to ensure that Crown land reserves were not mismanaged or used for other than specified purposes.	Program recently developed and implementation commenced Rate of Statewide coverage subject to resource allocation.
<i>Ministerial Portfolios, May 1997. p. 165</i>	A review of the <i>Alpine Resorts Act</i> , 1983, under the competition policy principles culminated in the announcement by the Government, in March 1997, that the Commission would cease to exist at the end of October 1997 and be replaced by new alpine resort operational management arrangements.	The Commission is to cease operations on 29 April 1998 and all alpine resorts to be managed by new independent boards of management. An Alpine Resorts Co-ordinating Council is to be established to co-ordinate the development of the resorts. In addition, an Alpine Resorts Unit is to be established to provide policy advice and corporate support to the Minister concerning the management of the resorts.

Ministerial Portfolios, May 1997. p.165 Given the sensitivity of environmental issues at alpine areas, particular attention will need to be given to the continued development of appropriate management plans and strategies to ensure the preservation of these unique areas for the benefit of future generations.

Ministerial Portfolios, May 1997. p.166 A review of the Commission's asset management practices found that systems and procedures had not been developed to effectively assess the condition of infrastructure other than buildings.

Ministerial Portfolios, May 1997. p.166 Future site lease agreements need to be appropriate site rentals at the various resorts.

ALPINE RESORTS COMMISSION

Ministerial Portfolios, April 1992 p.408. There was an absence of appropriate performance measures which provide assurance to the Government that the Commission is meeting the aims of the tourism strategy and fulfilling its role and objectives under its legislation.

Performance measures have now been developed. Under recent reforms, the Commission will be abolished at the end of October 1997.

MELBOURNE WATER INDUSTRY REFORM

Ministerial Portfolios, May 1996, p. 215. The community service function of parks and waterways has not been completely separated from the commercial business of supplying water, sewerage and drainage services as the Melbourne Water Corporation continues to provide \$14 million a year to fund the operations of Melbourne Parks and Waterways.

As from the 1996-97 financial year, the Corporation will no longer be required to make a separate contribution to the Consolidated Fund to finance the activities of Melbourne Parks and Waterways now operating as Parks Victoria.

Ministerial Portfolios, May 1996, p. 218. Performance measures and indicators established to assess the comparative performance of the 3 retail water companies are not publicly available. As a result, customers cannot assess the overall performance of the retail water companies.

The Regulator-General annually prepares a report providing customers with data on the performance of the retail water industry as a whole, and the relative performance of each individual retail water company. The first report was issued in May 1996.



*Ministerial
Portfolios,
May 1996,*
p. 219.

The Office of the Regulator-General has engaged the services of consultants with international experience to assist in the development of benchmarks, performance indicators and targets. Until these indicators and benchmarks are established, effective independent monitoring and regulation of the industry will not be completed.

Development of suitable indicators and benchmarks is progressing.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED - continued

MELBOURNE WATER INDUSTRY REFORM - continued

<p><i>Ministerial Portfolios, May 1996, p. 221.</i></p>	<p>Although the interests of consumers are largely protected through the Government's cap on the fixed component of the water and sewerage charges until July 1998, delaying the Regulator-General's first price review may leave consumers vulnerable to price increases for a 3 year period to 2001. In addition, until the Regulator-General undertakes a pricing review he is unable to determine the financial viability of the Melbourne Metropolitan Water Industry.</p>	<p>Water and Sewerage charges are currently under review by the Department of Treasury and Finance.</p>
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<p><i>Ministerial Portfolios, May 1996, p. 230.</i></p>	<p>In the absence of appropriate information systems to accurately assess the condition and maintenance requirements of infrastructure assets, planned maintenance expenditure may be understated. In addition, the Corporation cannot effectively determine the timing and cost of major capital enhancement and renewal expenditure.</p>	<p>Melbourne Water continues to develop its information systems to improve its management of fixed asset maintenance.</p>
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ROYAL BOTANIC GARDENS BOARD

<p><i>Ministerial Portfolios, May 1994, pp. 136-46.</i></p>	<p>Agreement with the Government is required on the future level of funding to be provided to the Board.</p> <p>Action is required to ensure adequate registration and storage of the National Herbarium collection.</p>	<p>Annual funding provided by Government to the Botanic Gardens Board is approved in accordance with its Board's business plan.</p> <p>Appropriate action has commenced.</p>
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VICTORIAN INSTITUTE OF MARINE SCIENCES

<p><i>Ministerial Portfolios, May 1994, pp. 151-3.</i></p>	<p>To ensure the future financial viability of the Institute, action is required to implement effective management and financial policies, practices and information systems.</p>	<p>On 1 July 1996, the Institute amalgamated with the Victorian Fisheries Research Institute to form the Marine and Freshwater Resources Institute.</p>
<p><i>Ministerial Portfolios, May 1994, pp. 154-5.</i></p>	<p>Annual action plans, incorporating performance measures, should be developed and implemented as a means of supporting the Institute's strategic direction plan.</p>	<p>A strategic business plan has been prepared for the Marine and Freshwater Resources Institute, which incorporates performance measures.</p>



SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - *continued*

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
NO ACTION TAKEN		
MELBOURNE WATER CORPORATION		
<p><i>Second Report, 1986-87, pp. 164-5.</i></p> <p><i>Ministerial Portfolios, May 1990, p. 343.</i></p> <p><i>May 1992, p. 432.</i></p>	<p>The enabling legislation does not confer on the Corporation the authority to levy interest on arrears of rates and charges. In contrast, the legislation of other major rating bodies provides for the levying of interest on overdue amounts.</p>	<p>The 3 metropolitan retail water companies assumed responsibility for the raising of water rates in 1995. As was previously the case with the Corporation, these companies do not have the legislative power to levy interest on arrears of rates and charges.</p>
MELBOURNE WATER INDUSTRY REFORM		
<p><i>Ministerial Portfolios, May 1996, p. 221.</i></p>	<p>In order to strengthen the Regulator-General's control over pricing policy, the Government should consider the introduction of a licence, monitored by the Regulator-General, to cover the provision of the Melbourne Water Corporation's services.</p>	<p>Position unchanged.</p>
<p><i>Ministerial Portfolios, May 1996, p. 222.</i></p>	<p>If the performance of the Melbourne Water Corporation and the retail water companies is to be effectively benchmarked against comparable interstate and overseas water utilities, valuing fixed assets based on the current cost of their replacement rather than historical cost may be more appropriate.</p>	<p>Melbourne Water and the 3 retail water companies do not plan to revalue their fixed assets in the short-term.</p>

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Department of Natural Resources and Environment	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	10 Oct. 1996	10 Oct. 1996
AGRICULTURE AND RESOURCES				
Alberton River Improvement Trust	30 June 1996	" "	22 Sept. 1996	27 Sept. 1996
Australian Food Industry Science Centre	30 June 1996	" "	25 Oct. 1996	30 Oct. 1996
Avoca River Management Board	30 June 1996	" "	26 Sept. 1996	2 Oct. 1996
Barwon Region Water Authority	30 June 1996	" "	4 Oct. 1996	4 Oct. 1996
Broken River Management Board	30 June 1996	" "	1 Oct. 1996	1 Oct. 1996
Central Gippsland Region Water Authority	30 June 1996	" "	20 Aug. 1996	13 Sept. 1996
Central Highlands Region Water Authority	30 June 1996	" "	19 Sept. 1996	19 Sept. 1996
City West Water Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	20 Sept. 1996	20 Sept. 1996
Coliban Region Water Authority	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	5 Sept. 1996	25 Sept. 1996
Daratech Pty Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	26 Sept. 1996	30 Sept. 1996
East Gippsland Region Water Authority	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	17 Sept. 1996	26 Sept. 1996
East Gippsland River Management board	30 June 1996	" "	15 July 1996	6 Sept. 1996
First Mildura Irrigation Trust	30 June 1996	" "	1 Oct. 1996	2 Oct. 1996
Gippsland and Southern Rural Water Authority	30 June 1996	" "	22 Aug. 1996	23 Sept. 1996
Glenelg Region Water Authority	30 June 1996	" "	27 Sept. 1996	2 Oct. 1996
Glenelg River Improvement Trust	30 June 1996	" "	29 Aug. 1996	24 Sept. 1996
Goulburn Murray Rural Water Authority	30 June 1996	" "	19 Sept. 1996	20 Sept. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
AGRICULTURE AND RESOURCES - continued				
Goulburn Valley Region Water Authority	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	4 Sept. 1996	4 Sept. 1996
Grampians Region Water Authority	30 June 1996	" "	25 Sept. 1996	25 Sept. 1996
Kiewa-Murray Region Water Authority	30 June 1996	" "	17 Sept. 1996	20 Sept. 1996
Korumburra River Improvement Trust	30 June 1996	" "	30 July 1996	28 Aug. 1996
Lake Wellington Rivers Authority	30 June 1996	" "	26 Nov. 1996	26 Nov. 1996
Lower Goulburn Waterway Management	30 June 1996	" "	23 Oct. 1996	23 Oct. 1996
Lower Murray Region Water Authority	30 June 1996	" "	15 Sept. 1996	20 Sept. 1996
Melbourne Market Authority	30 June 1996	" "	28 Aug. 1996	26 Sept. 1996
Melbourne Parks and Waterways	30 June 1996	" "	19 July 1996	19 July 1996
Melbourne Water Corporation	30 June 1996	" "	16 Aug. 1996	16 Aug. 1996
Mid-Goulburn Regional Water Board	30 June 1996	" "	27 Sept. 1996	27 Sept. 1996
Mitchell River Management Board	30 June 1996	" "	15 Nov. 1996	22 Nov. 1996
Murray Valley Citrus Marketing Board	30 June 1996	" "	1 Oct. 1996	1 Oct. 1996
Murray Valley Wine Grape Industry Development Committee	31 July 1996	" "	1 Nov. 1996	19 Dec. 1996
Northern Victorian Fresh Tomato Industry Development Committee	30 June 1996	" "	5 Dec. 1996	7 Jan. 1997
Otway Region Water Authority	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
Ovens Region Water Authority	30 June 1996	" "	13 Sept. 1996	13 Sept. 1996
Ovens River Management Board	30 June 1996	" "	1 Oct. 1996	1 Oct. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
AGRICULTURE AND RESOURCES - continued				
Pental Island River Management Board	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	30 Sept. 1996	11 Oct. 1996
Portland Coast Region Water Authority	30 June 1996	" "	11 Sept. 1996	27 Sept. 1996
Radius Computing Pty Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	16 Aug. 1996	16 Aug. 1996
Renewable Energy Authority of Victoria	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	23 Sept. 1996	24 Sept. 1996
Snowy River Improvement Trust	30 June 1996	" "	21 Sept. 1996	3 Oct. 1996
South East Water Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	26 Aug. 1996	26 Aug. 1996
South Gippsland Region Water Authority	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	16 Aug. 1996	27 Sept. 1996
South West Water Authority	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
Sunraysia Rural Water Authority	30 June 1996	" "	17 Sept. 1996	24 Sept. 1996
Tambo Nicholson River Management Board	30 June 1996	" "	23 Sept. 1996	1 Oct. 1996
Tarwin River Management Board	30 June 1996	" "	13 Nov. 1996	19 Nov. 1996
Upper Goulburn Waterways Authority	31 July 1996	" "	16 Sept. 1996	15 Oct. 1996
Upper North East River Management Board	30 June 1996	" "	5 Nov. 1996	23 Dec. 1996
Victorian Dairy Industry Authority	30 June 1996	" "	30 Sept. 1996	1 Oct. 1996
Victorian Dried Fruits Board	30 June 1996	" "	18 Oct. 1996	30 Oct. 1996
Victorian Institute of Marine Sciences (a)	30 June 1996	" "	15 Oct. 1996	8 Nov. 1996 (g)
Victorian Meat Authority	30 June 1996	" "	27 Sept. 1996	27 Sept. 1996
Victorian Plantations Corporation	30 June 1996	" "	30 Aug. 1996	30 Aug. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
AGRICULTURE AND RESOURCES - continued				
Victorian Strawberry Industry Development Committee	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	16 Sept. 1996	10 Dec. 1996
Water Training Centre	30 June 1996	" "	25 Sept. 1996	27 Sept. 1996
Western Region Water Authority	30 June 1996	" "	9 Sept. 1996	27 Sept. 1996
Westernport Region Water Authority	30 June 1996	" "	27 Aug. 1996	27 Sept. 1996
Wimmera Malley Rural Water Authority	30 June 1996	" "	6 Sept. 1996	24 Sept. 1996
Yarra Valley Water Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	22 Aug. 1996	22 Aug. 1996
CONSERVATION AND LAND MANAGEMENT				
Alpine Resorts Commission	31 Oct. 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	20 Dec. 1996	20 Dec. 1996
Bairnsdale Waste Management Group	30 June 1996	" "	11 Dec. 1996	24 Jan. 1997
Bundoora Park Committee of Management (b)	30 June 1995	" "	31 Jan. 1996	4 Jun. 1996
Eastern Regional Waste Management Group	30 June 1995	" "	11 April 1996	15 May 1996
Environment Protection Authority	30 June 1996	" "	8 Oct. 1996	9 Oct. 1996
Mount Macedon Memorial Cross Committee of Management (c)	31 Dec. 1992, 31 Dec. 1993, 31 Dec. 1994, 1 Jan. 1995 to 18 April 1995	No reporting requirements.	30 Nov. 1995	23 Oct. 1996
" "	" "	" "	" "	" "
" "	" "	" "	" "	" "
" "	" "	" "	" "	" "
Northern Regional Refuse Disposal Group	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46	15 Oct. 1996	11 Dec. 1996
Penguin Reserve Committee of Management	30 June 1996	" "	25 Sept. 1996	3 Oct. 1996 (g)

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
CONSERVATION AND LAND MANAGEMENT - continued				
Recycling and Resource Recovery Council (d)	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46	13 Sept. 1996	18 Sept. 1996
Royal Botanic Gardens Board	30 June 1996	" "	16 Aug. 1996	13 Sept. 1996
Shrine of Remembrance Trustees	30 June 1994	No reporting requirements.	27 Mar. 1996	23 Oct. 1996
" "	30 June 1995	" "	23 Jul. 1996	6 Jan. 1997
" "	30 June 1996	" "	2 Dec. 1996	6 Jan. 1997
South Eastern Regional Waste Management Group	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46	23 Sept. 1996	30 Sept. 1996
Surveyors Board of Victoria	30 June 1996	" "	15 Nov. 1996	22 Nov. 1996
Trust for Nature (Victoria)	30 June 1996	" "	17 Sept. 1996	4 Oct. 1996 (g)
Waste Management Council (d)	30 June 1996	" "	26 Sept. 1996	1 Oct. 1996
Western Regional Waste Management Group	30 June 1996	" "	23 Sept. 1996	30 Sept. 1996
Yarra Bend Park Trust	30 June 1996	" "	23 Aug. 1996	23 Sept. 1996
Zoological Board of Victoria	30 June 1996	" "	29 Aug. 1996	6 Sept. 1996
Zoological Board of Victoria Superannuation Fund (e)	30 June 1996	" "	9 Dec. 1996	10 Dec. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
INCOMPLETE AUDITS				
NATURAL RESOURCES AND ENVIRONMENT				
Bundoora Park Committee of Management (b)	1 July 1995 to 19 Jan. 1996	19 May. <i>Financial Management Act 1994</i> , s.46		Draft financial statements received. Audit in progress.
Eastern Regional Waste Management Group	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	" "	
Port Bellarine Committee of Management	30 Sept. 1994	30 Jan. <i>Financial Management Act 1994</i> , s.46.	" "	
" "	1 Oct. 1994 to 30 June 1995	31 Oct. <i>Financial Management Act 1994</i> , s.46.	" "	
" "	30 June 1996	" "	" "	
State Swimming Centre Committee of Management	30 June 1995	" "	" "	
" "	30 June 1996	" "		Financial statements not received.
AGRICULTURE AND RESOURCES				
Bullock Creek River Improvement Trust	30 June 1996	" "	" "	
Tangamah Shire Water Board	30 June 1996	" "	" "	
Veterinary Board of Victoria	31 Dec. 1996	31 April. <i>Financial Management Act 1994</i> , s.46.	" "	
Victorian Institute of Marine Sciences Superannuation Fund (f)	30 June 1989	No reporting requirements.		Audit substantially completed.
" "	30 June 1990	" "	" "	

(a) Victorian Institute of Marine Sciences combined with Victorian Fisheries Research Institute to form Marine and Freshwater Research Institute from 1 July 1996.
 (b) Ceased operations on 19 January 1996.
 (c) Ceased operations on 18 April 1995.
 (d) Recycling and Resource Recovery Council and Waste Management Council combined to form Eco Recycling as from 17 December 1996.
 (e) Ceased operations on 30 June 1996.
 (f) Ceased operation on 30 June 1990.
 (g) Qualified audit opinion issued.

Part 3.6

Premier and Cabinet

KEY FINDING

- The audit of the financial statements of the entities within the portfolio proved satisfactory.



3.6.1 The Premier, who is also the Minister for the Arts and Multicultural Affairs, has responsibility for operations within the Premier and Cabinet sector.

3.6.2 Details of the specific ministerial responsibilities for public bodies within the Premier and Cabinet sector are listed in Table 3.6A. These public bodies, together with the Department of the Premier and Cabinet, were subject to audit by the Auditor-General during the 1995-96 financial year.

**TABLE 3.6A
MINISTERIAL RESPONSIBILITY FOR
PUBLIC SECTOR AGENCIES WITHIN THE PREMIER AND CABINET SECTOR**

<i>Ministerial portfolio</i>	<i>Agencies subject to audit</i>
Arts	Council of the Museum of Victoria <i>(a)</i> Council of the State Library of Victoria <i>(b)</i> Council of Trustees of the National Gallery of Victoria Geelong Performing Arts Centre Trust State Library of Victoria Foundation Victorian Arts Centre Trust
Multicultural Affairs	Victorian Interpreting and Translation Service
Premier	Office of the Ombudsman Office of the Public Service Commissioner Victorian Auditor-General's Office Victorian Relief Committee

(a) Name changed to Museums Board of Victoria on 6 February 1997.

(b) Name changed to Library Board of Victoria on 6 February 1997.

3.6.3 The audit of the financial statements of the entities within the portfolios proved satisfactory.

3.6.4 Part 4.3 of this Report comments on the results of an audit of the management and utilisation of Corporate Cards across a number of agencies including the Department of Premier and Cabinet.



**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

VICTORIAN ARTS CENTRE TRUST

<p><i>Ministerial Portfolios, May 1994, pp.58-9.</i></p>	<p>A long-standing policy of non-allocation of significant levels of indirect overhead expenses (almost \$10 million in 1992-93) to individual operating units has impeded decision-making and led to incomplete transparency of accountability to the Parliament.</p>	<p>The Trust is now allocating indirect overhead expenses to operating units for management reporting purposes. Also, note disclosure of operating units activities is planned to be included in the 1996-97 financial statements which will include an allocation of indirect overhead expenses.</p>
<p><i>Ministerial Portfolios, May 1994, pp.68-9.</i></p>	<p>Since 1987, the Trust has pursued legal action to recover damages against a number of contractors and consultants over defects in the Arts Centre spire.</p>	<p>A successful court application to list the action in the <i>long cases</i> was made in December 1996. A number of orders were issued by the court which will result in a further hearing of the case in April 1997. The Trust remains confident of a successful recovery action.</p>

NO ACTION TAKEN

PREMIER AND CABINET

<p><i>Ministerial Portfolios, May 1996, pp. 242-4.</i></p>	<p>A review of executive contracts identified payments made to a former senior public servant of \$70 581 in excess of contract entitlements. In this case, the officer served as a member of a Board of a non-Victorian public body and received remuneration from the respective body for performing this role. Under the legislation establishing the particular public body, the officer was obligated to pay all the remuneration to the State. Upon receipt, the Department paid these moneys into a trust account and subsequently repaid these moneys back to the former employee.</p>	<p>The Department disagrees with audits interpretation of the contract of employment and the entitlements which it provided to the executive and is of the view that the employment contract entitled the executive to receive the payments concerned. As such, no recovery actions are planned to be instituted by the Department.</p>
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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS				
Department of the Premier and Cabinet	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	8 Oct. 1996	8 Oct. 1996
ARTS				
Council of the Museum of Victoria	30 June 1996	" "	23 Sept. 1996	30 Sept. 1996 (a) (b)
Council of the State Library of Victoria	30 June 1996	" "	30 Sept. 1996	9 Oct. 1996 (a) (c)
Council of Trustees of the National Gallery of Victoria	30 June 1996	" "	30 Aug. 1996	16 Sept. 1996 (a)
Geelong Performing Arts Centre Trust	30 June 1996	" "	24 Sept. 1996	26 Sept. 1996
State Library of Victoria Foundation	30 June 1996	" "	30 Sept. 1996	9 Oct. 1996
Victorian Arts Centre Trust	30 June 1996	" "	23 Sept. 1996	26 Sept. 1996
MULTICULTURAL AFFAIRS				
Victorian Interpreting and Translation Service	30 June 1996	" "	7 Aug. 1996	8 Aug. 1996
PREMIER				
Office of the Ombudsman	30 June 1996	" "	1 Oct. 1996	1 Oct. 1996
Office of the Public Service Commissioner	30 June 1996	" "	1 Oct. 1996	1 Oct. 1996
Victorian Auditor-General's Office (d)	30 June 1996	" "	2 Sept. 1996	2 Sept. 1996
Victorian Relief Committee	30 June 1996	" "	7 Oct. 1996	15 Oct. 1996

(a) Qualified audit report issued.

(b) Name changed to Museums Board of Victoria on 6 February 1997.

(c) Name changed to Library Board of Victoria on 6 February 1997.

(d) The Victorian Auditor-General's Office was audited by a firm of private auditors.

Part 3.7

State Development

KEY FINDING

- The audit of the financial statements of the entities within the portfolio proved satisfactory.

3.7.1 The Minister for Industry, Science and Technology, the Minister for Multimedia, the Minister for Sport and Rural Development and the Minister for Small Business and Tourism have responsibility for operations within the State Development sector. These Ministers have collective responsibility for the Department of State Development.

3.7.2 Details of the specific ministerial responsibilities for public bodies within the State Development sector are listed in Table 3.7A. These public bodies, together with the Department of State Development, were subject to audit by the Auditor-General during the 1995-96 financial year.

**TABLE 3.7A
MINISTERIAL RESPONSIBILITIES FOR
PUBLIC BODIES WITHIN THE STATE DEVELOPMENT SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Industry, Science and Technology	Construction Industry Long Service Leave Board Exhibition Trustees (a) Melbourne Exhibition Centre Trust (b) Overseas Projects Corporation of Victoria Ltd Victorian Medical Consortium Pty Ltd
Multimedia	Film Victoria State Film Centre of Victoria Council
Small Business	Liquor Licensing Commission Small Business Victoria (c)
Sport	Greyhound Racing Control Board Harness Racing Board Melbourne and Olympic Parks Trust Melbourne Sports and Aquatic Centre Trust Victorian Institute of Sport Ltd Victorian Institute of Sport Trust
Tourism	Australian Grand Prix Corporation Emerald Tourist Railway Board Tourism Victoria

(a) Ceased operations on 31 March 1996 and functions transferred to Museums Board of Victoria.

(b) Abolished on 5 February 1997 and functions transferred to the newly established Melbourne Convention and Exhibition Trust.

(c) Functions transferred to Department of State Development on 1 January 1997.

3.7.3 The audit of the financial statements of the entities within the portfolio proved satisfactory.

3.7.4 The Department of State Development has policy responsibility for Government information, technology and telecommunication. Included in Parts 4.4 and 4.5 of this Report are 2 articles which outline a number of issues that require attention in relation to the management of information technology across the public sector, dealing with:

- the capacity of date sensitive software and large databases to cope with the change of dates from 1999 to 2000; and
- information technology security.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
MATTERS RESOLVED OR ACTION COMMENCED		
FORMER DEPARTMENT OF BUSINESS AND EMPLOYMENT		
<i>Ministerial Portfolios, May 1994, p. 91.</i>	The Occupational Health and Safety Authority's workplace inspection program relating to targeted industries and activities was not based on a sound risk-based planning framework.	A "Site-Assessment" targeting system was implemented in June 1996. The system identifies workplace hazards and assesses how those hazards are managed by the workplace.
<i>Ministerial Portfolios, May 1994, pp. 98-9.</i>	Given the complementary activities of the Authority and the Victorian WorkCover Authority, a review should be undertaken to investigate the potential for the integration of the 2 bodies to form a single entity responsible for workplace injury prevention, compensation and employee rehabilitation.	With effect from 2 July 1996, the functions and staff of the Health and Safety Authority were transferred to the Victorian WorkCover Authority.

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Department of State Development	30 June 1996	31 Oct. <i>Financial Management Act 1994, s.46.</i>	27 Sept. 1996	27 Sept. 1996
INDUSTRY, SCIENCE AND TECHNOLOGY				
Construction Industry Long Service Leave Board	30 June 1996	" "	19 Sept. 1996	19 Sept. 1996
Exhibition Trustees	Period 1 Jan. 1996 to 31 Mar. 1996	31 July. <i>Financial Management Act 1994, s.46.</i>	26 Sept. 1996	26 Sept. 1996 (a)
Melbourne Exhibition Centre Trust	30 June 1996	31 Oct. <i>Financial Management Act 1994, s.46.</i>	28 Oct. 1996	29 Oct. 1996 (b)
Overseas Projects Corporation of Victoria Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994, s.53A.</i>	11 Oct. 1996	15 Oct. 1996
Victorian Medical Consortium Pty Ltd	30 June 1996	" "	29 Aug. 1996	29 Aug. 1996

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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
MULTIMEDIA				
Film Victoria	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	11 Oct. 1996	21 Oct. 1996
State Film Centre of Victoria Council	30 June 1996	" "	17 Sept. 1996	30 Sept. 1996 (c)
SMALL BUSINESS				
Liquor Licensing Commission	30 June 1996	" "	25 Sept. 1996	26 Sept. 1996
Small Business Victoria	30 June 1996	" "	3 Sept. 1996	10 Sept. 1996
Small Business Victoria	Period 1 July to 1996 to 31 Dec. 1996	30 April. <i>Financial Management Act 1994</i> , s.46.	10 April 1997	17 April 1997 (d)
SPORT				
Greyhound Racing Control Board	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	9 Sept. 1996	11 Sept. 1996
Harness Racing Board	30 June 1996	" "	21 Oct. 1996	25 Oct. 1996
Melbourne and Olympic Parks Trust	30 June 1996	" "	8 Oct. 1996	8 Oct. 1996
Melbourne Sports and Aquatic Centre Trust	Period 1 June 1995 to 30 June 1996	" "	29 April 1997	29 April 1997
Victorian Institute of Sport Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	18 Sept. 1996	24 Sept. 1996
Victorian Institute of Sport Trust	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	18 Sept. 1996	24 Sept. 1996
TOURISM				
Australian Grand Prix Corporation	30 June 1996	" "	27 Aug. 1996	27 Aug. 1996
Emerald Tourist Railway Board	30 June 1996	" "	25 Sept. 1996	30 Sept. 1996
Tourism Victoria	30 June 1996	" "	4 Sept. 1996	5 Sept. 1996

(a) Ceased operations on 31 March 1996 and functions transferred to Museums Board of Victoria.

(b) Abolished on 5 February 1997 and functions transferred to Melbourne Convention and Exhibition Trust.

(c) Qualified audit report issued.

(d) Functions transferred to Department of State Development on 1 January 1997.

Part 3.8

Treasury and Finance

KEY FINDINGS

Local Authorities Superannuation Board - unfunded superannuation liabilities

- The unfunded superannuation liability of the Local Authorities Superannuation Board totalled \$329.1 million at 30 June 1996, an increase of \$111.5 million over the previous year. *Paras 3.8.4 to 3.8.9*
- The major reason for the increase in the unfunded superannuation liability in the year was the higher than anticipated level of retrenchments prompted by the reform of Local Government, without a commensurate requirement being imposed by the Board on councils to immediately fund the additional superannuation costs. *Para 3.8.9 to 3.8.12*
- A total of \$253 million was paid in retrenchment superannuation benefits to council staff during the year ended 30 June 1996, which was significantly in excess of actuarial and budget estimates. *Para. 3.8.12*
- Notwithstanding the adverse trend over an extended period, it was not until late 1996 that the Board responded to the emerging experience of the plan being at variance with the actuarial assumptions underpinning the funding position of the plan. *Paras 3.8.13 to 3.8.17*

Financial standing of WorkCover

- While the WorkCover scheme has remained fully funded, its funding level decreased from 102.9 per cent at 30 June 1995 to 100.6 per cent at 31 December 1996. *Paras 3.8.18 to 3.8.26*
- The recent legislative reforms, in effect, result in lower real annual claim payments therefore more funds will remain in the WorkCover scheme to generate a higher investment return. *Paras 3.8.32 to 3.8.33*
- The WorkCover Authority has relied substantially on the transfer of \$320 million of surplus moneys from the Supplementation and Guarantee Funds to achieve and maintain the fully funded position of the WorkCover scheme. *Paras 3.8.34 to 3.8.39*



KEY FINDINGS - continued

Financial standing of WorkCover - continued

- While the WorkCover scheme's financial position has stabilised, there are emerging claims cost pressures which will remain a key factor in the Authority's management focus to enable the Scheme to stay fully funded and to be in a position to maintain a competitive premium rate for employers.

Paras 3.8.40 to 3.8.42

Privatisation of Hazelwood and Energy Brix

- The successful bidder for Hazelwood was assessed as having the superior overall package as it exceeded alternative offers by a significant amount.

Paras 3.8.62 to 3.8.72

- The net benefit to the State from the sale of Hazelwood and Energy Brix was \$1.5 billion after taking account of related costs, including estimated costs of sale of \$10 million.

Paras 3.8.73 to 3.8.77

- The State has provided financial support to Energy Brix of \$83.3 million since the 1993-94 financial year, including \$30.7 million mainly to fund future liabilities associated with the potential closure of the business.

Paras 3.8.82 to 3.8.84

- The State only received \$8.9 million in relation to the sale of the Energy Brix business even though the reported book value of its net assets was recorded at \$28.7 million as at the date of its sale.

Para. 3.8.85

- On the basis of current Government projections, it is estimated that the State will derive on-going net savings of \$584 million per annum from the electricity privatisation that has occurred up to the date of preparation of this Report.

Paras 3.8.86 to 3.8.87

- In June 1996 the Treasurer issued a directive to Generation Victoria which effectively restricted its ability to freely compete in the wholesale electricity market, resulting in the under-utilisation of its gas entitlement under the gas supply agreement. Consequently, Generation Victoria was required to pay \$26 million for the unused portion of gas under the take-or-pay supply agreement.

Paras 3.8.94 to 3.8.100

- During the period July 1996 to March 1997, Generation Victoria only operated the Newport and Jeeralang power stations at an average utilisation rate of 7.9 per cent and 2.5 per cent respectively. Accordingly, the value of these power stations which is currently estimated at \$105 million needs to be re-assessed.

Paras 3.8.101 to 3.8.103

KEY FINDINGS - continued**Petroleum Resources Rent Tax (PRRT) dispute settlement**

- The PRRT dispute settlement arrangements which cost the State \$502 million, including legal and associated costs of \$43 million, represented a favourable outcome.

Paras 3.8.125 to 3.8.133

- Under new arrangements which will remain in operation until no later than December 2009, the State has accepted certain anti-competitive gas supply contractual arrangements and a significant take-or-pay obligation in relation to the annual nominated gas quantity that GASCOR is required to consume.

*Paras 3.8.142 to 3.8.150***Reform of Victorian ports**

- It was identified that the redundancy packages available to port employees were on average 36 per cent higher than those available within the budget sector, with an estimated cost differential of \$8.1 million.

Paras 3.8.163 to 3.8.167

- Audit was advised that the higher redundancy packages paid to port employees reflects the more favourable awards and agreements operating within this sector, as compared to the budget sector, and the impact of the consultative process established to reach agreement with the relevant unions.

*Para. 3.8.168***State Revenue Office - revenue collection**

- The positive action taken by the State Revenue Office in recent years has resulted in a substantial overall reduction in the level of uncollected taxes.

Paras 3.8.171 to 3.8.174

- The improvement in the level of debts outstanding for a period greater than 90 days and in particular for taxes which have remained uncollected for more than one year has been marginal, which is largely due to the impact of the 6 major cases which were the subject of protracted legal procedures.

Paras 3.8.175 to 3.8.176

- During the period July 1994 to January 1997, the State Revenue Office wrote-off \$31.5 million in uncollected taxes and fees.

Paras 3.8.177 to 3.8.178



3.8.1 The Treasurer and Ministers for Finance and Gaming have responsibility for operations within the Treasury and Finance sector. These Ministers have collective responsibility for the Department of Treasury and Finance.

3.8.2 Details of the specific ministerial responsibility for public bodies within the Treasury and Finance sector are listed in Table 3.8A. These public bodies, together with the Department of Treasury and Finance were subject to audit by the Auditor-General during the 1995-96 financial year.

**TABLE 3.8A
MINISTERIAL RESPONSIBILITY FOR
PUBLIC BODIES WITHIN THE TREASURY AND FINANCE SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Finance	Emergency Services Superannuation Board Hospitals Superannuation Board Local Authorities Superannuation Board Port of Geelong Authority Superannuation Fund Regulator General, Office of the Victorian Superannuation Board, administering: <ul style="list-style-type: none"> • Coal Mine Workers' Pensions Fund • Holmesglen Constructions Superannuation Plan (a) • Parliamentary Contributory Superannuation Fund • State Casual Employees Superannuation Fund (a) • State Employees Retirement Benefits Fund (b) • State Superannuation Fund • Transport Superannuation Fund (a) • Victorian Superannuation Fund Victorian WorkCover Authority Water Industry Superannuation Fund (c) Water Industry Superannuation Fund Pty Ltd
Gaming	Tabcorp Holdings Limited Club Keno Business Segment Tabcorp Manager Pty Ltd Gaming Business Segment Tattersall Gaming Machine Division Tattersall Sweep Consultation Tattersall's Club Keno Totalizator Agency Board Victorian Casino and Gaming Authority
Treasurer	Aluminium Smelters of Victoria Pty Ltd and its subsidiaries: <ul style="list-style-type: none"> • Alufin Pty Ltd • Alupac Pty Ltd • Aluvic Aerospace Pty Ltd (d) • Aluvic Castings Pty Ltd • Aluvic Metal Sales Pty Ltd • Portland Smelter Unit Trust Citipower Ltd (e) Eastern Energy Ltd (e) Ecogen Energy Ltd Electricity Services Victoria Energy Brix Australia Corporation (f) Energy Brix Australia Corporation Pty Ltd (g) Everton Dell Pty Ltd Gas and Fuel Corporation Superannuation Fund Gas Transmission Corporation GASCOR Generation Victoria Hazelwood Power Corporation Ltd (g) Loy Yang B Power Station Pty Ltd (h) Loy Yang Power Ltd

TABLE 3.8A
MINISTERIAL RESPONSIBILITY FOR
PUBLIC BODIES WITHIN THE TREASURY AND FINANCE SECTOR - continued

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Treasurer - cont.	Melbourne Port Corporation (i) Melbourne Port Servicers Pty Ltd (i) National Electricity Pty Ltd Port of Geelong Authority Port of Melbourne Authority Port of Portland Authority Powercor Australia Ltd (e) PowerNet Victoria Rural Finance Corporation Securities Finance Corporation Ltd Solaris Power Ltd (e) Southern Hydro Ltd State Electricity Commission of Victoria State Insurance Office (j) State Trustees Ltd STL Financial Services Ltd The Albury Gas Company Ltd Transport Accident Commission and its subsidiaries: <ul style="list-style-type: none"> • Holding Trust • Opalwood Pty Ltd • Rehabilitation Holdings Pty Ltd • Southgate Control Limited • Southgate Hotel Management Pty Ltd • Southgate Trust • TAC Property Investments Pty Ltd • Victorian Rehabilitation Centre Pty Ltd Treasury Corporation of Victoria Tricontinental Australia Ltd Tricontinental Corporations Ltd Tricontinental Holdings Ltd Twin Waters Resort Pty Ltd Utilities Insurance Company Pty Ltd (k) V.E.I. Superannuation Pty Ltd Vicfleet Pty Ltd Victorian Channel Authority Victorian Electricity Industry Superannuation Fund Victorian Funds Management Corporation Victorian Managed Insurance Authority Victorian Power Exchange Vistel Ltd (l) Yallourn Energy Ltd (m)

- (a) Plan ceased on 31 March 1996, members' funds transferred to Victorian Superannuation Fund.
 (b) Fund ceased on 31 May 1996, members' funds transferred to State Superannuation Fund.
 (c) Formerly known as Melbourne Water Corporation Employees' Superannuation Fund.
 (d) Formerly Aluvic Services Pty Ltd
 (e) Sold to private sector entity as at 30 September 1995.
 (f) Corporatised and name changed to Energy Brix Australia Corporation Pty Ltd on 15 July 1996.
 (g) Sold to private sector entity as at 13 September 1996.
 (h) Sold to private sector entity in May 1997.
 (i) Inaugural reporting period to Parliament covers period 1 March 1996 to 30 June 1997.
 (j) Ceased operations on 30 September 1996. Activities transferred to Victorian Managed Insurance Authority.
 (k) Sold to private sector entity as at 31 March 1996.
 (l) Sold to Telstra as at 30 June 1996.
 (m) Sold to private sector entity as at 29 February 1996.

3.8.3 Comment on matters of significance arising from the audit of entities within the Treasury and Finance sector is provided below.

LOCAL AUTHORITIES SUPERANNUATION BOARD

UNFUNDED SUPERANNUATION LIABILITIES

3.8.4 The Local Authorities Superannuation Board provides superannuation services to Victorian local government entities, non-metropolitan water bodies and cemetery trusts. The Board currently operates 4 superannuation plans, comprising:

- 3 defined benefits plans, under which member benefits are related to employee age, years of service and final remuneration; and
- an accumulation plan, introduced in 1994, under which member benefits accrue over time based on employer and employee contributions and the investment earnings of the plan.

3.8.5 The defined benefits plan, which applies mainly to the local government sector, has had, for many years, an unfunded liability which represents the difference between the value of the net assets of the plan and the actuarial estimate of the value of the accrued benefits of past and present members.

3.8.6 Since March 1989, employing authorities under the *Local Authorities Superannuation Act* 1988 have been contributing to the plan at the rate of 13.25 per cent of the salary of employee members. The contribution rate comprises 2 components, namely:

- a normal contribution of 9.25 per cent, to meet the cost of benefits accruing each year; and
- a surcharge of 4 per cent, to progressively eliminate the unfunded liability for current and past members, which has been operative for over 10 years.

3.8.7 Based on the latest triennial actuarial estimate, undertaken as at June 1995, the current contribution rate was expected to be sufficient to ensure that the defined benefits plan applicable to local government would reach a fully funded status by the year 2012.

3.8.8 My May 1996 *Report on Ministerial Portfolios* commented on the defined benefit schemes' unfunded liability in respect of council employees as at 30 June 1995. This current Report analyses the performance of the scheme since that date.

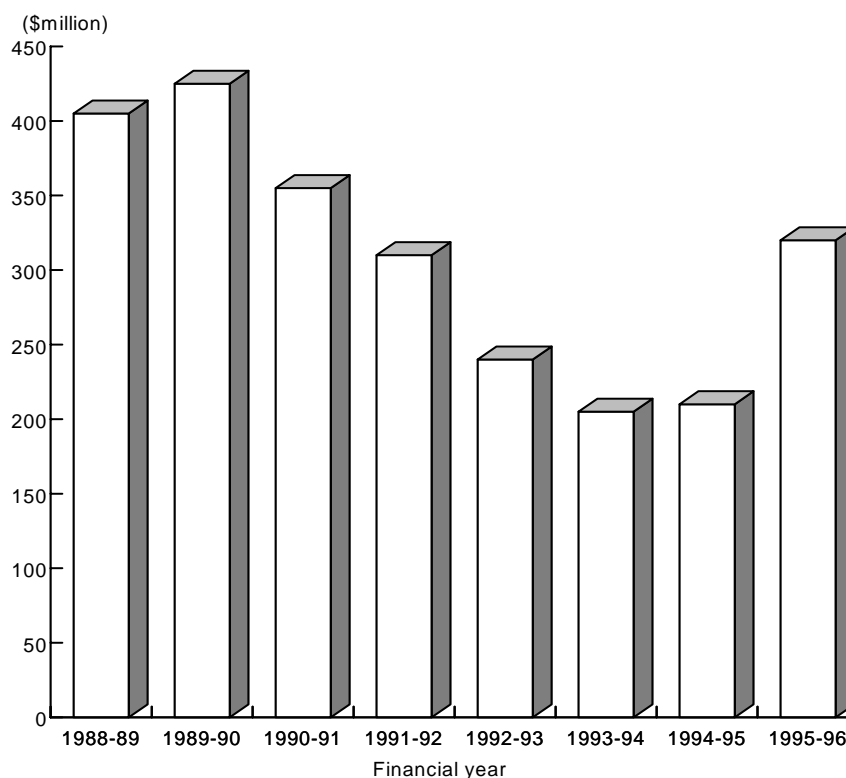
Current position

3.8.9 The annual report of the Board, including the audited financial statements for the year ended 30 June 1996, which was tabled in the Parliament on 31 October 1996 disclosed an unfunded superannuation liability of \$329.1 million for the defined benefits scheme, representing an increase of \$111.5 million since the previous year. The increase in the unfunded liability arose mainly as a consequence of:

- the higher than anticipated level of retrenchments prompted by the reform of local government, without a commensurate requirement being imposed by the Board on councils to immediately fund the additional superannuation costs; and
- the transfer to the Board of all existing unfunded liabilities amounting to \$10.9 million relating to defined benefits superannuation plans formerly operated for employees of the City of Melbourne and Melbourne Parks.

3.8.10 Chart 3.8B shows the level of the Board's unfunded liability from 1988-89 to 1995-96.

**CHART 3.8B
UNFUNDED SUPERANNUATION LIABILITY,
1988-89 TO 1995-96**





3.8.11 As shown in the chart, between 1988-89 and 1994-95, the unfunded liabilities of the plan declined significantly, indicating that the achievement of a fully funded status for the plan was on target at that time. However, the chart indicates that the plan's unfunded liability increased significantly in the 1995-96 financial year. Estimates prepared by the Board indicate that, by 30 June 1997, the plan's unfunded liability will be \$330 million.

3.8.12 The major reasons for the increase in the plan's unfunded liability since 1994-95 are:

- A greater than forecast number of retrenchments within local government during the latter part of 1995 and in 1996. The 1995 triennial actuarial valuation of the plan assumed that there would be between 1 700 and 2 500 retrenchments in the period July 1995 to December 1996. In fact, approximately 4 700 retrenchments occurred, mainly as a consequence of council amalgamations and unsuccessful internal council compulsory competitive tendering bids. **A total of \$253 million was paid in retrenchment benefits during the year ended 30 June 1996, which was significantly in excess of actuarial and budget estimates;**
- A greater than forecast number of retirements as a consequence of council amalgamations and unsuccessful internal council compulsory competitive tendering bids;
- The closure of the defined benefits plan to new members on 31 December 1993 as part of the Government's reform of public sector superannuation schemes. As a consequence of the plan's closure, annual surcharge income decreased from \$35 million at December 1993 to \$22.3 million at June 1996 due to the lower total salary base upon which the surcharge was levied. As a result, based on actuarial advice, in September 1995 the Board extended the target date to eliminate the plan's unfunded liabilities from 2006 to 2012, rather than increase the surcharge rate; and
- As mentioned previously, the transfer to the Board of the unfunded liabilities of \$10.9 million relating to the defined benefit plans previously operated by the City of Melbourne and Melbourne Parks.

Action taken to reduce the unfunded superannuation liability

3.8.13 Between September 1995 and December 1996, there has been a significant increase in the number of retrenchments from the local government sector which has had a detrimental impact on the plan's financial position. **Notwithstanding this adverse trend over an extended period, it was not until late 1996 that the Board responded to the emerging experience of the plan being at variance with the actuarial assumptions underpinning the funding position of the plan.**

3.8.14 In December 1996, the Board advised employers that it was considering the introduction of a new charge to assist in alleviating the funding shortfall. However, this proposal was not viewed favourably by employers.



3.8.15 In February 1997, the Board established a working party, comprising industry and government representatives, to consider strategies to meet the obligations of the plan. A document entitled *Information Paper - Unfunded Liability* was prepared by the Board and distributed to all employers, which:

- described the impact that changing employment practices of councils was having on the solvency of the plan;
- explained the current and prospective difficulties associated with the historical funding approach adopted for funding the plan's liabilities; and
- invited comment on 4 alternatives for funding the plan's liabilities.

3.8.16 The funding options, as detailed in the information paper, were based on actuarial advice and included:

- Maintaining the current approach to meeting the unfunded liability, which is based on a surcharge payable by employers levied on the salaries of the remaining members. The adoption of this approach would see the surcharge increased to 10 per cent as from July 1997, then increasing to at least 14 per cent by the year 2002. However, if retrenchments and resignations continue at the current rate, in the longer-term, the surcharge would need to be increased significantly;
- Maintaining the current approach to funding the accruing superannuation costs (currently 9.25 per cent of employee salaries) and for employers to separately finance the unfunded liability. The amount required to finance the unfunded liability would range between \$43 million and \$55 million a year in 1997 dollars over a 15 year period and a 10 year period, respectively;
- In cases where retrenchments continue beyond 30 June 1997 and equity between employers is considered desirable, then those employers retrenching employees would become liable to pay a contribution equivalent to 32 per cent of the retrenchment benefit. While this amount would not have to be paid immediately the retrenchment benefit is paid by the plan, it could be added to the employer's individual unfunded liability obligations and repaid to the plan by 30 June 2007. Interest on the outstanding balance would accrue at the net earning rate applicable to the defined benefit plan; and
- A combination of the above options.

3.8.17 Consultation between the Government, employers and industry associations is currently in progress to determine what action is required to meet the plan's escalating unfunded superannuation liabilities. At the date of the preparation of this Report, the Board was yet to make a final decision on the actions to be implemented to ensure the plan achieves a fully funded position over a reasonable period of time.

□ **RESPONSE** provided by the President, Local Authorities Superannuation Board

I wish to add a brief comment about Board actions in response to recent changes in local government employment.

Retrenchment is only one of many factors which influence the Scheme's financial position. The real rate of return earned by the Scheme is usually the more important factor determining the level of unfunded liabilities.

The 1995 Actuarial Investigation revealed that the Scheme's financial position had improved by approximately \$97 million over the preceding 3 years, despite retrenchments exceeding the explicit allowance by 3 125. This overall improvement was due to various favourable factors, particularly the real rate of return which averaged 4.8 per cent a year compared with the 2.5 per cent a year long-term funding assumption. Notwithstanding this result, the Board decided it was prudent to:

- *make explicit allowance for future retrenchments;*
- *extend the target date for full funding to 2012; and*
- *monitor scheme indicators closely pending any revision.*

Retrenchment numbers varied dramatically month-to-month, although cumulatively they were higher than expected. Numbers peaked in September 1995. Investment returns continued to progress favourably and the Board had no reason to carry out a comprehensive analysis of the total Scheme position prior to the regular annual accounts being prepared.

Once the 1995-96 annual accounts were available to the Board in September 1996, it was clear that other aspects of the Scheme's financial experience had not offset the higher than anticipated number of retrenchments over the 12 months to 30 June 1996.

At its November 1996 meeting, the Board decided to investigate modifications to existing funding arrangements and advised authorities in December 1996 that it was considering a "top-up" contribution on future retrenchments.

FINANCIAL STANDING OF WORKCOVER - UPDATE

3.8.18 My May 1996 *Report on Ministerial Portfolios* commented on the financial standing of the WorkCover scheme which is administered by the Victorian WorkCover Authority. In that Report, it was identified that there has been a significant improvement in the financial position of the WorkCover scheme in recent years, with the scheme achieving a fully funded position at 30 June 1995, which was some 2 years ahead of the Government's expectations. The key factors contributing to the achievement of the scheme's fully funded status at 30 June 1995 were:

- major legislative reforms by the Government to enable the introduction of premium incentives and changes to the entitlement criteria and benefit structure to reduce the number of eligible claims and to improve the return to work rates of employees and the safety performance of employers;
- changes in the strategic management of the scheme;

- transfer by the Authority of surplus funds of approximately \$260 million from the pre-WorkCare Supplementation and Guarantee Funds to the WorkCover Fund; and
- introduction of an active marketing and education campaign.

3.8.19 The following paragraphs provide an update of the financial position of the WorkCover scheme since my previous Report.

Performance of WorkCover scheme

3.8.20 The Government’s key financial objective for the WorkCover scheme is for the Authority to maintain the scheme’s full-funding position. In this regard, for the 18 month period to December 1996, this objective was achieved.

3.8.21 Table 3.8C highlights the financial position of the scheme for the period 30 June 1995 to 31 December 1996. **In particular, the table shows that while the scheme has remained fully funded, its funding level, that is the percentage of the scheme’s net assets in relation to its outstanding claims liability, decreased from 102.9 per cent at 30 June 1995 to 100.6 per cent at 31 December 1996.**

TABLE 3.8C
FINANCIAL POSITION OF THE WORKCOVER
SCHEME, 30 JUNE 1995 TO 31 DECEMBER 1996
 (\$million)

	30 June 1995	30 June 1996	31 December 1996
Outstanding claims liability(a)	2 486	2 876	3 127
Net assets	2 558	2 931	3 146
Surplus assets	72	55	19
Funding level (per cent)	102.9%	101.9%	100.6%

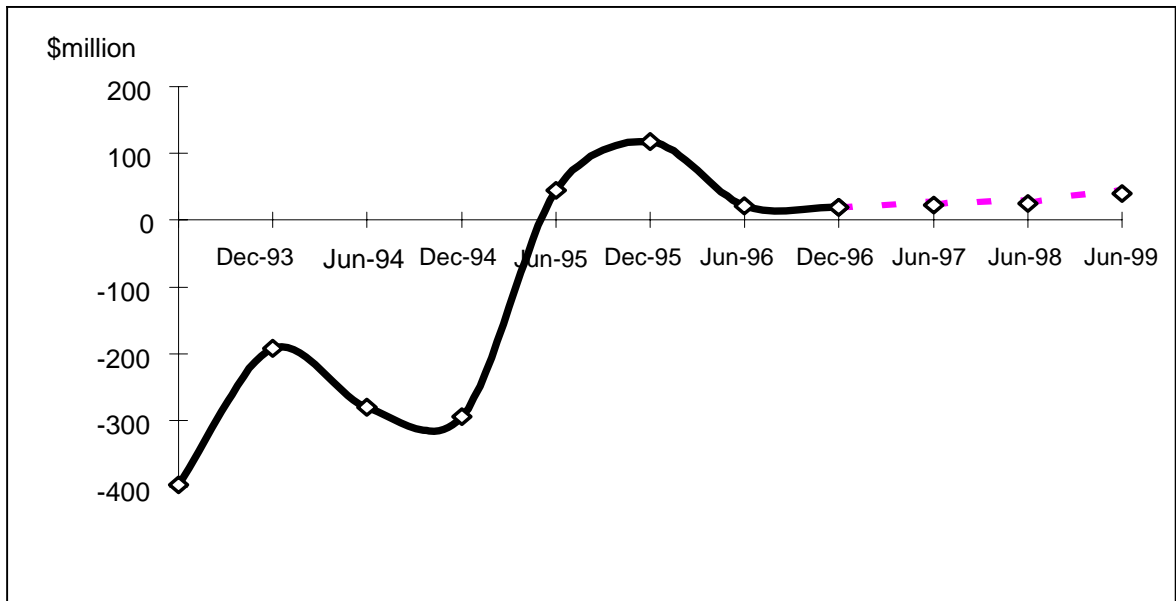
(a) Represents net present value.

3.8.22 The key factor contributing to the reduced funding level of the WorkCover scheme as at 31 December 1996 was an increase of \$641 million in the Authority’s outstanding claims liability since 30 June 1995. The majority of this increase was not projected and was mainly caused by:

- worsening claims experience; and
- changes in the economic assumptions used by the actuaries which have increased in real terms the quantum estimated to be payable for each claim.

3.8.23 The increase in the outstanding claims liability of the WorkCover scheme has in turn placed substantial pressure on the Authority to maintain its full-funding position. Chart 3.8D shows the scheme’s funding position since June 1993 and the Authority’s actuarial projections of the funding position to June 1999.

CHART 3.8D
WORKCOVER SCHEME'S FUNDING POSITION FROM JUNE 1993 TO DECEMBER 1996,
INCLUDING ACTUARIAL PROJECTIONS TO JUNE 1999
 (\$million)



3.8.24 The chart highlights that the scheme's financial position substantially improved, from a deficit of \$396 million (82 per cent funding level) in June 1993 to a surplus of \$118 million (104 per cent funding level) in December 1995, with the position stabilising at around a 100 per cent funding level from June 1996 to December 1996. The chart also shows that, based on projections provided by the Authority's consulting actuaries, the scheme's surplus at 30 June 1999 is anticipated to be around \$40 million, representing a funding level of 101 per cent.

3.8.25 For the 18 month period to December 1996, the scheme's full-funding position has been maintained mainly due to the impact of the following factors:

- legislative reforms in December 1996 which, inter alia, removed the eligibility of injured workers to claim for secondary psychological impairment as a component of serious injury, thereby reducing the outstanding claims liability estimate;
- transfer to the scheme of \$60 million from the Supplementation and Guarantee Insurance Funds;
- favourable investment performance by the Authority over the period; and
- earlier settlement of claims.

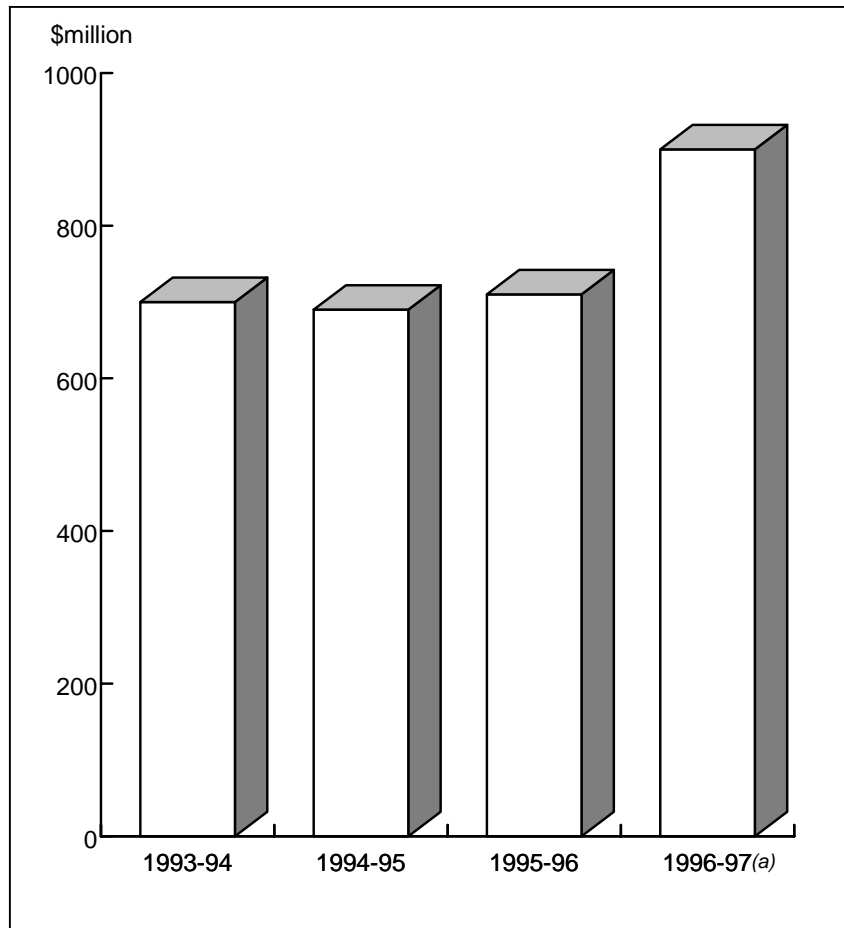
3.8.26 Even though during the 1995-96 financial year the Government removed the premium levy surcharge payable by employers which was originally introduced to eliminate the previous WorkCare scheme deficit, the effect of the removal of the surcharge on the scheme's funding level was minimal for the 6 month period to 31 December 1996.

Scheme claim costs

3.8.27 As previously outlined in this Report, in the 18 month period to December 1996, the Authority’s outstanding claims liability increased by \$641 million (or 26 per cent), substantially due to the worsening trend in claims experience and, to a lesser extent, a change in the economic assumptions used by the actuaries in the valuation of the liability. The main factors contributing to the worsening trend in claims experience were an increased number of claimants receiving larger benefits for longer periods and a higher number and success rate of common law cases against the Authority (compared with prior year trends).

3.8.28 Chart 3.8E shows that the level of annual claim payments are anticipated to increase by around \$200 million in the 1996-97 financial year when compared with the level of actual payments made during the 1994-95 financial year.

CHART 3.8E
CLAIM PAYMENTS, FINANCIAL YEARS 1993-94 TO 1996-97
 (\$million)



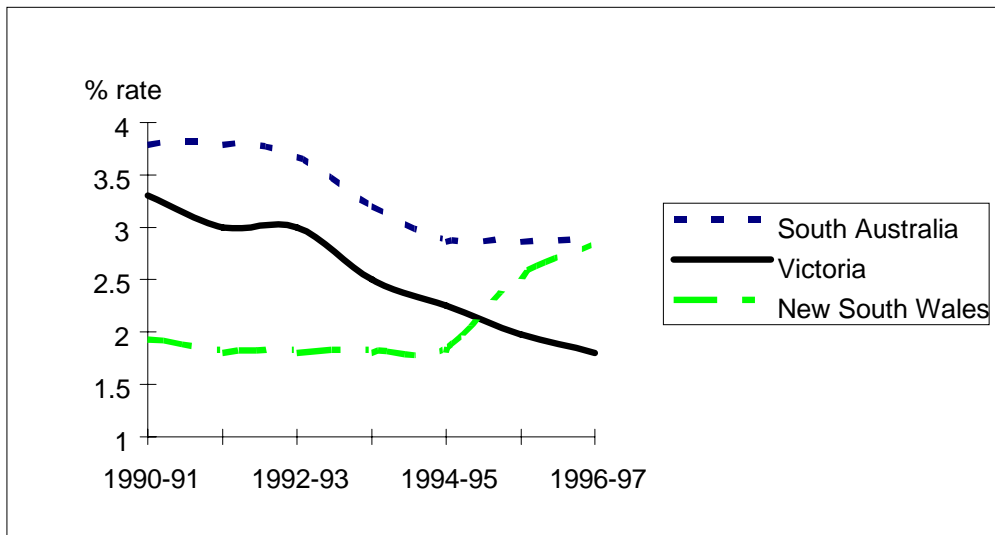
(a) Represents projected annual claim payments.

3.8.29 Given the significant emerging claim cost pressures on the Victorian workers’ compensation scheme, the Authority needs to continue to closely monitor and manage the scheme to ensure the maintenance of its fully-funded position.

Removal of the premium surcharge

3.8.30 A premium levy surcharge was introduced by the Government in 1993 to address the accumulated deficit of \$2.1 billion of the former WorkCare scheme. Given the substantial improvement in the scheme's financial standing, the Government in March 1996 announced the removal of this surcharge, resulting in a 10 per cent reduction on the prior year's average premium rate. Following the removal of the surcharge, Victorian employers now pay the lowest workers' compensation premium rate, compared with other comparable workers' compensation schemes, in Australia. Chart 3.8F outlines a comparison of average premium rates of comparable workers' compensation schemes in Australia.

**CHART 3.8F
COMPARISON OF
AVERAGE PREMIUM RATES TO OTHER COMPARABLE STATE SCHEMES**



3.8.31 The above chart shows that the Victorian average premium rates has decreased from 3.3 per cent in 1990-91 to 1.8 per cent in 1996-97. This has been achieved while maintaining a fully-funded position and compares favourably with other comparable schemes.

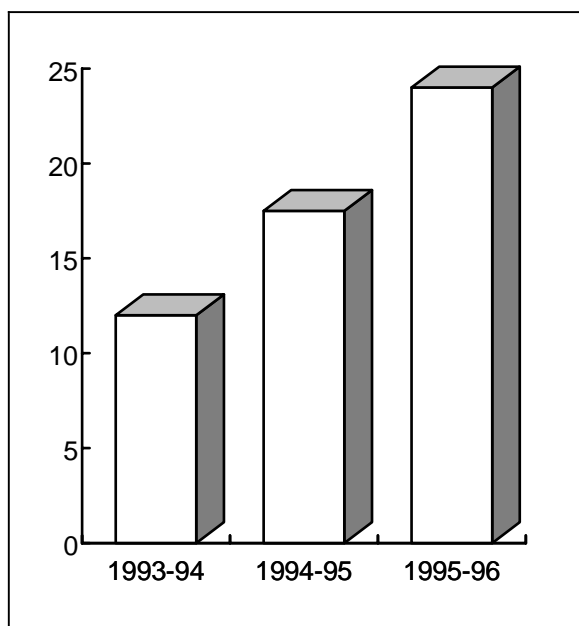
Recent legislative reforms

3.8.32 Since my previous Report on Ministerial Portfolios to the Parliament, a number of further amendments have been made to the *Accident Compensation Act 1985*, including:

- Removal of claimants' eligibility for serious injury benefits arising from claims for secondary psychological impairment. Chart 3.8G outlines the gradual increase in serious injury claims involving secondary psychological impairment over the past 3 years.



CHART 3.8G
PROPORTION OF SERIOUS INJURY CLAIMS
INVOLVING SECONDARY PSYCHOLOGICAL IMPAIRMENT
(per cent)



- The Authority has estimated that the total cost savings resulting from this legislative change will be in the order of \$656 million by the year 2000;
- Establishment of a requirement that a determination of impairment must be made prior to commencement of common law proceedings. Previous to this amendment, there was no restriction on the timing of such determination, which resulted in a higher number of common law writs being issued against the Authority;
- Introduction of new provisions relating to lump sum compensation for pain and suffering to address the inappropriate use of legal processes which have generated substantial lump sum main transaction costs. The new provisions cover, among other things:
 - mandatory exchange of medical information at the initial claim processing stage;
 - improved conciliation processes;
 - substantial increase of the jurisdictional limits of the Magistrates Court for lump sum compensation and weekly payments;
 - empowerment of the Minister to issue binding directions on the resolution of disputes; and



- Payment over a period of 5 years rather than as a single lump sum of compensation (including compensation for pain and suffering) involving amounts greater than \$5 000. The Minister for Finance has provided an undertaking that this provision will not be proclaimed until the Commonwealth Government's Department of Social Security clarifies whether these compensation annuity payments will affect claimants' social security benefits and whether the payments will be treated, for taxation purposes, consistent with lump sum payments.

3.8.33 The recent legislative reforms, in effect, result in lower real annual claim payments therefore more funds will remain in the WorkCover Fund to generate a higher investment return.

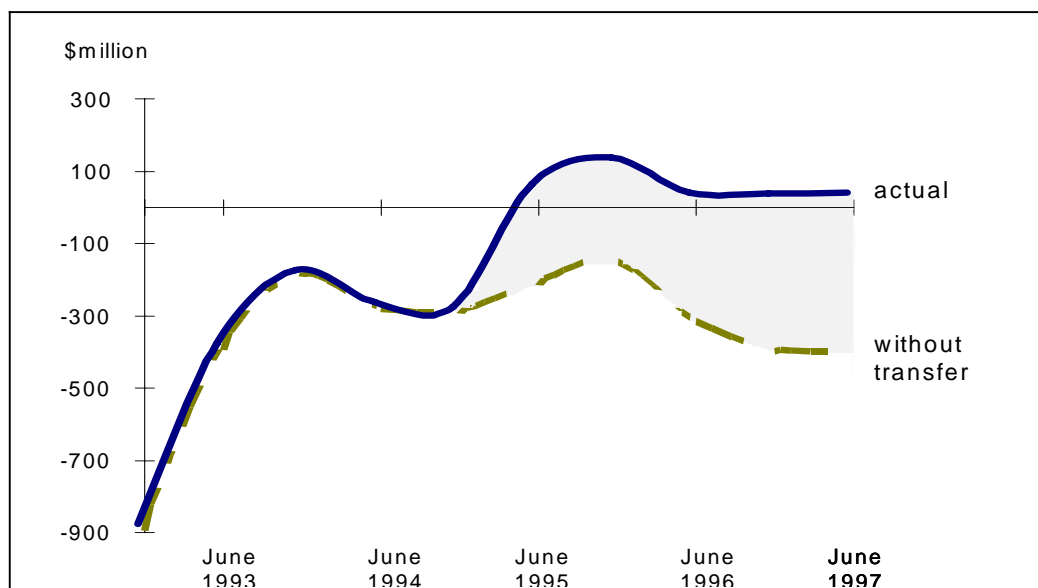
Use of Supplementation and Guarantee Funds

3.8.34 The Workers' Supplementation Fund and the Compensation Supplementation Fund were set-up, prior to the establishment of the former WorkCare scheme, to recompense employers and insurers for additional benefits payable for claims under pre-WorkCare scheme legislation. Furthermore, the Insurer's Guarantee Fund was established to finance the workers' compensation liabilities of any insurer unable to meet its liabilities. The income of these Funds were derived from surcharges on workers' compensation insurance policies issued prior to the introduction of the former WorkCare scheme and an allocation of part of the levy payable to the former WorkCare scheme.

3.8.35 The Authority assumed responsibility for the above Supplementation and Guarantee Funds on 1 December 1992 and, since June 1995, has determined to progressively transfer any surplus funds to the WorkCover Fund. **Since June 1995, \$320 million has been transferred from the Supplementation and Guarantee Funds to the WorkCover Fund.**

3.8.36 Chart 3.8H shows the impact on the actual funding position of the WorkCover scheme of the transfers from the Supplementation and Guarantee Funds.

CHART 3.8H
IMPACT ON THE WORKCOVER SCHEME OF THE TRANSFERS FROM THE
SUPPLEMENTATION AND GUARANTEE FUNDS
 (\$million)



3.8.37 The chart shows that the Authority has relied substantially on the transfer of surplus moneys from the Supplementation and Guarantee Funds to achieve and maintain the fully funded position of the WorkCover scheme. If the Supplementation and Guarantee Funds surplus assets had not been transferred into the WorkCover Fund by the Authority, the premium surcharge on employers may have remained in force for a longer period. Furthermore, the application of the surpluses from the Supplementation and Guarantee Funds towards the WorkCover scheme has provided a means of indirectly redistributing the Funds' surpluses back to the employers through reduced premium rates.

3.8.38 The excess of assets over liabilities of the Supplementation and Guarantee Funds at 31 December 1996 was \$51 million. Given that these Funds are in a run-off situation and that, in the future, there will be less surplus funds available for transfer to the WorkCover Fund, the Authority will need to continue to pro-actively manage the financial position of the WorkCover scheme.

3.8.39 In this regard, other initiatives being undertaken by the Authority to enhance the management of the scheme include:

- provision of financial incentives to insurers to improve claims management;
- increased scrutiny of claims;
- encouraging insurers to more rigorously monitor and manage medical costs;
- marketing and education programs relating to the WorkCover scheme;
- extensive injury prevention programs;
- undertaking employer remuneration audits;

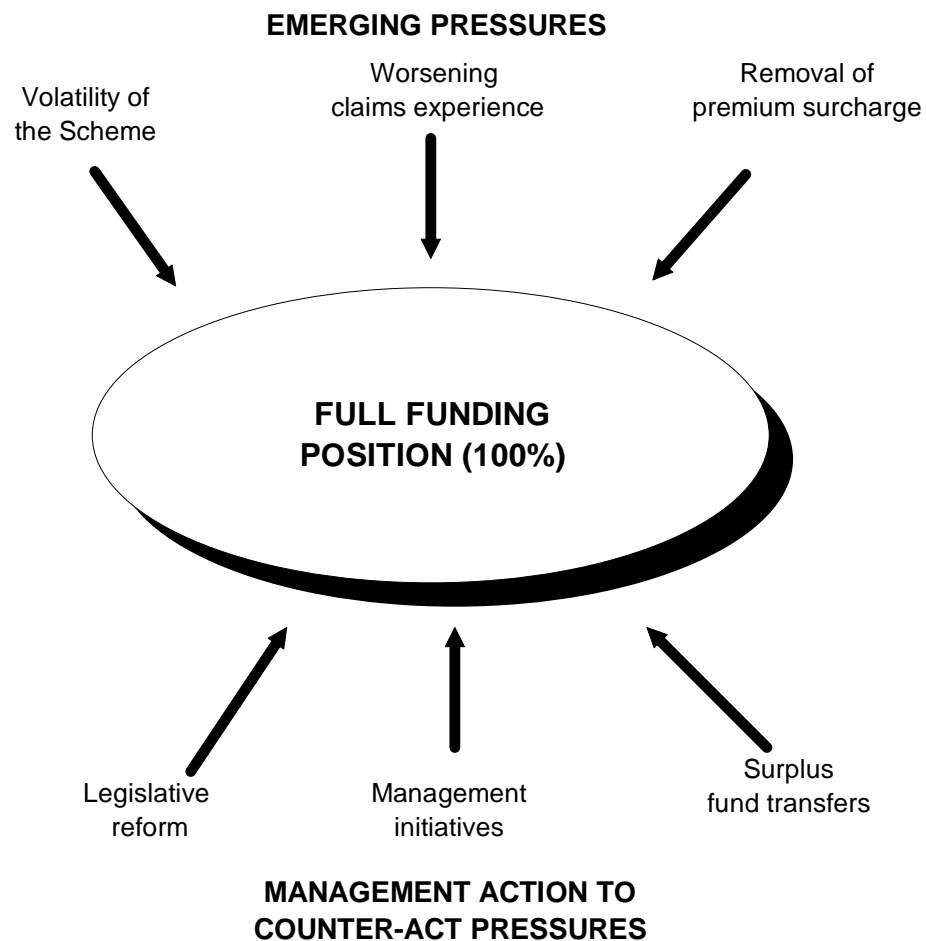


- performing reviews to ensure that authorised insurers effectively meet their responsibilities;
- amalgamation of compensation and occupational health and safety organisations to improve the co-ordination of prevention and compensation activities; and
- placing greater emphasis on injury prevention and the earlier return to work of injured employees.

Overall comment

3.8.40 The WorkCover scheme operates in a dynamic environment in which management action is required to counter act the emerging pressures on its on-going financial viability in order to maintain a fully funded position for the scheme. Chart 3.8I illustrates the key emerging pressures on the scheme and the key management actions required to address these pressures.

**CHART 3.8I
WORKCOVER SCHEME - KEY MANAGEMENT ISSUES AND ACTIONS**





3.8.41 The Authority has, since its inception, managed the transition from the WorkCare scheme to the WorkCover scheme through the implementation of major legislative reforms, transfers of surplus funds from the Supplementation and Guarantee Funds and through the introduction of other management initiatives. The positive financial impact of these measures has in turn enabled the progressive removal of the employer premium surcharge levied on Victorian employers over the past 4 years, which has assisted in the funding of the previous WorkCare scheme's \$2.1 billion deficit.

3.8.42 While the WorkCover scheme's financial position has stabilised, there are emerging claims cost pressures which will remain a key factor in the Authority's management focus to enable the Scheme to stay fully funded and to be in a position to maintain a competitive premium rate for employers.

NO RESPONSE was provided by the Victorian WorkCover Authority to the issues raised.

VICTORIAN ELECTRICITY INDUSTRY PRIVATISATION

3.8.43 My previous Reports to the Parliament have provided detailed comment on the Government's electricity industry reform program which commenced in 1994. The program initially involved the restructure of the Victorian electricity industry from a State-owned monopoly to a new competitive structure mainly comprising electricity distribution businesses and generation companies and, subsequently, the progressive privatisation of these newly established distribution and generation businesses.

3.8.44 The electricity distribution businesses, which were privatised during the 1994-95 financial year, each comprise a distribution network and a retail function which supplies electricity to franchise customers on a geographic basis, and to contestable customers on a Statewide basis. A detailed analysis of the sale of these businesses was provided in my May 1996 *Report on Ministerial Portfolios* to the Parliament.

3.8.45 The State's electricity generation companies are based around the vast brown coal reserves in the Latrobe Valley, located approximately 150 kilometres east of Melbourne. The major generation companies include:

- *Yallourn Energy Ltd* - which owns and operates the Yallourn W Power Station and the associated brown coal mine. In March 1996, the company was sold by the State to a consortium comprising foreign and local investors. A comprehensive analysis of the sale was outlined in my October 1996 *Report on the Statement of Financial Operations, 1995-96*;
- *Hazelwood Power Corporation Ltd* - which owns and operates the Hazelwood Power Station and the associated brown coal mine. The Government announced the sale of this company in August 1996;



- *Energy Brix Australia Corporation* - which owns and operates the Morwell briquette plant and a 170 megawatt power station. The brown coal used in the company's operations is supplied by Hazelwood Power Corporation Ltd and Yallourn Energy Ltd under contractual arrangements. The Government also announced the sale of Energy Brix in August 1996;
- *Loy Yang Power Ltd* - which operates the Loy Yang A Power Station and the associated brown coal mine. At the time of preparation of this Report, the company was owned by Victorian taxpayers, however, the Government was in the final stages of negotiating the sale of the business. The results of this sale will be analysed by audit and reported in a subsequent Report to the Parliament; and
- *Loy Yang B Power Station Pty Ltd* - which was a wholly-owned subsidiary of Power Net Victoria, holding a 49 per cent interest in the Loy Yang B Power Station under a joint venture arrangement with the Latrobe Power Partnership, an organisation controlled by a United States-based utility, Edison Mission Energy (EME). In April 1997, the Government announced that it had reached an agreement with EME under which the State's 49 per cent interest in the Loy Yang B power station was assumed by EME and certain associated State financial obligations were terminated or restructured. An analysis of these arrangements will be reported in a subsequent Report to the Parliament.

3.8.46 The State's electricity industry also includes a number of smaller generation entities, generally supplying power to meet intermediate and peak capacity requirements, including 2 gas-fired stations operated by Generation Victoria (one in the Melbourne suburb of Newport and the other, Jeeralang, in the Latrobe Valley) and 3 hydro-electric schemes operated by Southern Hydro Ltd. The State also owns and operates:

- *Victorian Power Exchange* - which is responsible for the provision of a wholesale electricity market to Victorian electricity participants and the operation of the electricity transmission network; and
- *Power Net Victoria* - whose primary function is to operate and maintain the high-voltage electricity transmission grid which provides transmission services to electricity participants by transmitting electricity from the generators to the distributors. In April 1997, the Government announced its intention to privatise this entity, which represented a change from previous plans that the national electricity market would involve a single grid owned by all participating States and Territories.

3.8.47 The Commonwealth Government and most eastern-State Governments are currently in the process of developing a national electricity market as a means of increasing competition and obtaining greater economic efficiency from the industry. In particular, as at the date of preparation of this Report, a transitional national electricity market was proposed to commence as from April 1997 involving Victoria, New South Wales and the Australian Capital Territory, with South Australia to become a full participant in the Victorian wholesale electricity market.



3.8.48 As previously mentioned, in August 1996, the Government announced the joint sale of Hazelwood Power Corporation Ltd and Energy Brix Australia Corporation. In this Report, I have provided a comprehensive analysis of these sales.

3.8.49 Consistent with my previous Reports on the electricity privatisation program, while audit conducted a financial analysis of the sale results, the audit did not extend to an examination of the extent to which the Government's economic policy objectives were achieved. In particular, the long-term nature of government reforms may prevent audit in the short-term from forming firm conclusions on this issue, given that the success or otherwise of privatisation will not, in many cases, be fully known for many years.

Hazelwood Power Corporation Ltd

3.8.50 Hazelwood Power Corporation Ltd was established in February 1995 following the disaggregation of Generation Victoria, which itself was formed following the initial split up of the SECV in January 1994.

3.8.51 Hazelwood's core function is the operation of a brown coal-fired thermal power station which was constructed progressively between the years 1964 and 1971 and is the second largest power station in Victoria, and the sixth largest in Australia. The power station has 8 generating units providing a capacity of up to 1 600 megawatts. One unit has been recently re-commissioned as a low reliability stand-by unit and one other unit is currently de-commissioned. The power station is fuelled from a neighbouring mine which has in excess of 40 years of coal supply, based on current usage rates.

3.8.52 According to the Government's information memorandum, which was issued to prospective bidders in June 1996, Hazelwood's power plant has been significantly underutilised in recent years, with 70 per cent of the plant's generation capacity unused during the year ended 30 June 1995, as compared with an underutilisation rate of 47 per cent for all Victorian generation plants. However, Hazelwood is anticipated to have a competitive advantage in a national electricity market, arising from the power station's large capacity and the overall flexibility provided by its relatively small generating units and low costs of production. On the basis of this competitive advantage, participation in the national electricity market is anticipated to provide opportunities for the company to substantially increase its electricity production and sales in future years.

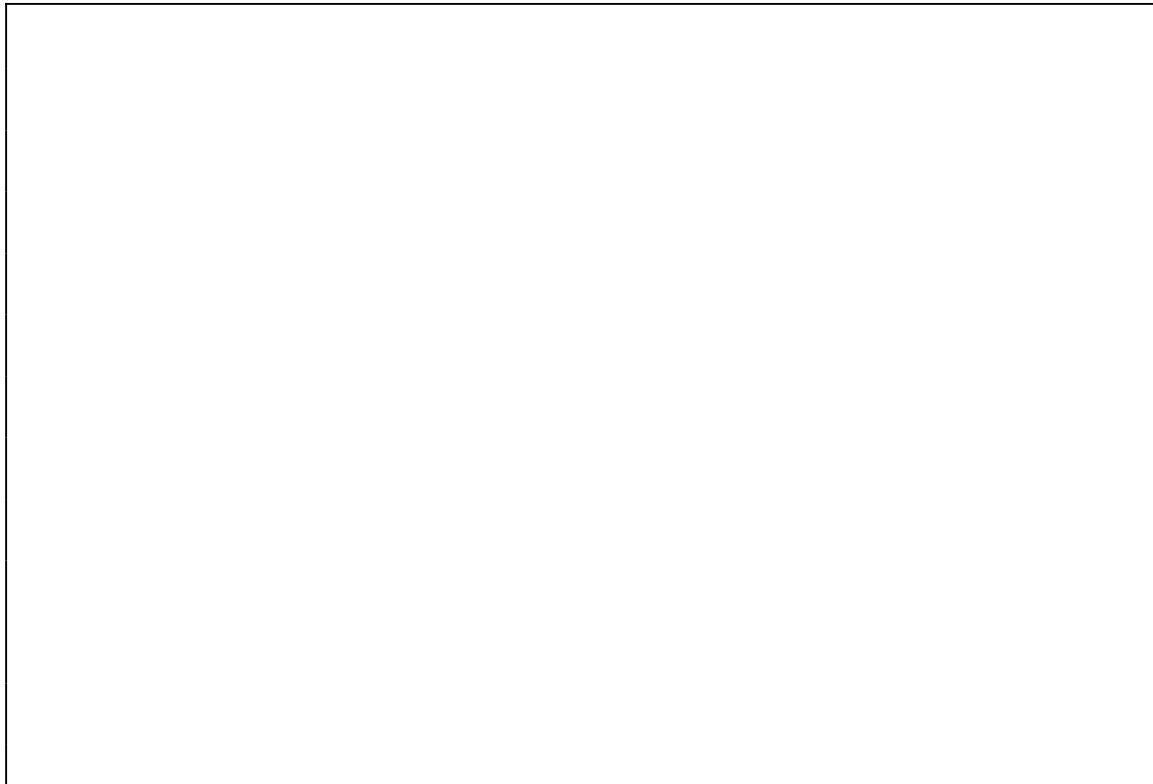
3.8.53 In the 1995-96 financial year, Hazelwood generated around 14.5 per cent of the electricity supplied to the Victorian wholesale electricity market. Approximately 70 per cent of Hazelwood's output was sold at prices established in hedging contracts with the 5 electricity distribution businesses and the Smelter Trader (a unit of the SECV which purchases electricity to supply aluminium smelter plants at Portland, and Point Henry, near Geelong). These contracts will continue to provide stability for a high proportion of Hazelwood's income until January 2000, when all retail customers will be contestable and retail electricity pricing de-regulated.

3.8.54 In July 1986, the SECV entered in an inter-connector operating agreement with the Electricity Commission of New South Wales and the Electricity Trust of South Australia (ETSA), which facilitated the construction of inter-connecting electricity transmission assets and the exchange of electricity between the south-eastern States as from March 1990, for a period of 20 years. However, as a result of concerns regarding the enforceability of this agreement, in December 1993, the SECV entered into a further contract which committed it to provide the ETSA with a firm energy capacity of 200 megawatts a year, and additional energy if available.

3.8.55 The later contract with the ETSA was subsequently transferred to Hazelwood in 1995 and expired in April 1997. The pricing of this contract was well below current market prices, accordingly, Hazelwood received support payments from other Victorian generators and the SECV to elevate revenue under the contract to prices equivalent to around 88 per cent of the contract price between the generators and the distribution businesses.

3.8.56 At the date of preparation of this Report, the Government was re-negotiating its obligations under the inter-connector operating agreement with the Government of South Australia, with the view to terminating this agreement to coincide with the expiry of the contract with the ETSA in April 1997. As from that date, the ETSA will purchase electricity directly from the Victorian wholesale electricity market. An analysis of the termination arrangements between the State and the ETSA will be included in a later Report to the Parliament.

3.8.57 A major issue concerning the future operations of all electricity generators, including Hazelwood, is the possible introduction by the Commonwealth Government of new environmental taxes, such as a carbon tax. However, under the current arrangements, the Government considers that such a tax would have to operate at very high levels before it could significantly affect Hazelwood's competitiveness in the wholesale market. In addition, the price hedging contracts allow for the pass-through of certain new taxes, such as environmental taxes, to the electricity distribution businesses, and ultimately to electricity consumers.



Hazelwood power station.

Energy Brix Australia Corporation Ltd

3.8.58 Energy Brix Australia Corporation Ltd was formed in October 1993 following the merger of the administrative and marketing arms of the former Coal Corporation of Victoria and a briquette manufacturing facility and power station complex in Morwell, which was formerly owned and managed by the SECV. The primary business of Energy Brix is the manufacture and sale of brown coal briquettes and other brown coal products, and the generation of electricity.

3.8.59 The complex now operated by Energy Brix initially commenced operations in 1959 and consists of 4 briquette factories and a co-generation plant comprising 5 electricity generating units with a total capacity of 170 megawatts. Of the 4 briquette factories, 2 are regularly utilised, with the third available on demand and the fourth decommissioned and used as a source of spare parts. The factories are currently producing around 450 000 tonnes of briquettes a year, with capacity to produce up to 1 million tonnes a year from the 3 available factories.

3.8.60 In relation to the electricity generation business of Energy Brix, coal for the production of steam used in the generation process is sourced from the Morwell open cut brown coal mine owned by Hazelwood. In relation to the briquetting business, Yallourn Energy Ltd is obligated to supply coal to Energy Brix until the expiration of a supply contract between the parties which will occur on or before October 1998. **In August 1996, the respective parties agreed that an option for the renewal of this coal supply contract will not be exercised.** Alternative sources of coal supply to Energy Brix are currently being investigated.

3.8.61 The briquette business has experienced substantial financial losses over many years under SECV management and only continued to operate as a going concern since the formation of Energy Brix in October 1993 with substantial financial support from the Government. As shown in Table 3.8J, Energy Brix has received grants, contributed capital and other funding from the Department of Treasury and Finance and the SECV totalling \$40.6 million since its inception, but has still reported aggregated operating losses before abnormal items of \$3.6 million.

TABLE 3.8J
GOVERNMENT FINANCIAL SUPPORT PROVIDED TO
ENERGY BRIX AND OPERATING RESULTS, 1993-94 TO 1995-96
 (\$million)

<i>Financial year</i>	<i>Government financial support</i>			<i>Operating result (a)</i>
	<i>Department of Treasury and Finance</i>	<i>SECV</i>	<i>Total</i>	
1993-94	15.2	4.0	19.2	2.6
1994-95	17.5	-	17.5	(0.3)
1995-96 (b)	3.9	-	3.9	(5.9)
Total	36.6	4.0	(c) 40.6	(3.6)

(a) Represents operating result before abnormal items.

(b) Financial period was extended to 14 July 1996.

(c) As discussed later in this Report, in addition to the financial support disclosed in the table, under the sale arrangements, Energy Brix was provided a further \$12.1 million for the purpose of funding capital works and other expenses. Furthermore, an amount of \$30.7 million was paid by the SECV into a "Closure Fund" to meet subsequent possible closure costs of the business.

Sale process - Hazelwood and Energy Brix

3.8.62 Following an assessment of the available options for the privatisation of Hazelwood and Energy Brix by the Department of Treasury and Finance and its advisors, it was concluded that a trade sale would achieve the maximum value for the State, based on the following rationale:

- such a sale was likely to achieve a substantially higher price than a float;
- a potential field of interested trade buyers already existed from the prior sale of Yallourn Energy in March 1996;
- a trade sale process was considered more appropriate for the privatisation of Energy Brix; and
- a float was susceptible to political interference and prevailing stock market conditions.

3.8.63 On the basis of this assessment, in May 1996, Cabinet approved the sale of Hazelwood and Energy Brix on the basis of a trade sale process.



3.8.64 In April 1996, potential purchasers who had previously shown interest in the acquisition of Victorian electricity businesses, and major Australian financial advisors, were invited to submit expressions of interest in the purchase of Hazelwood. Expressions of interest for the acquisition of the entire company were subsequently received from 4 parties but one party later withdrew. However, a number of other parties also expressed interest in the company but only sought minority positions in any consortium that may have been subsequently established.

3.8.65 Prior to the preparation of a short list of bidders, in May 1996, the Government identified a number of issues which could impact on the result that was achieved by the State from the sale of Hazelwood including:

- Varying levels of investor confidence in improved volumes and revenues to be derived from a national electricity market. Preliminary financial analysis indicated that the final sale price for Hazelwood could vary considerably depending on investor expectations in relation to the national electricity market; and
- Depressed pool prices for wholesale electricity during the first half of 1996, which were impacted by various factors including:
 - The early commissioning in April 1996 of Unit 2 of the Loy Yang B power station, which added to the available supply of electricity;
 - The assignment to Hazelwood of certain other generators' contractual obligations to provide power to South Australia under the energy export contract entered into between the SECV and the Electricity Trust of South Australia. The Department of Treasury and Finance advised that despite the consequential reduced power requirement from other generators, these businesses did not reduce their output, creating an over-supplied market;
 - Aggressive price bidding in the pool by Generation Victoria, arising from its take or pay obligations under a gas supply agreement (further comment on this issue is provided later in this Report); and
 - A mild summer in the 1995-96 financial year.

3.8.66 An information memorandum for the sale of Hazelwood was issued in June 1996 to the 3 consortia that had previously expressed an interest in the acquisition of the company, inviting the submission of bids by August 1996. However, the Government subsequently decided that Hazelwood and Energy Brix would be sold as a package, given their close trading relationships which included:

- Hazelwood's obligation to supply coal to Energy Brix for its electricity generating units;
- the obligation of Energy Brix to supply briquettes to Hazelwood for use as a starter fuel; and
- Hazelwood has coal in its mine which may be suitable for briquette production and could be supplied to Energy Brix.

.....

3.8.67 Consequently, the Government informed the short-listed bidders of its preference to receive combined bids for Hazelwood and Energy Brix. However, the bidders were advised that they could make arrangements with third parties for the purchase of Energy Brix, with any such third party bids required to be included with their bids for Hazelwood. Subsequently, the Government issued an information memorandum for Energy Brix to the 3 Hazelwood bidders and to potential bidders only interested in acquiring Energy Brix.

3.8.68 In August 1996, following the completion of due diligence inquiries by bidders, 3 binding bids were lodged. These bids were subsequently evaluated by an evaluation team comprising representatives from the Department of Treasury and Finance, and financial and legal advisors. The bids were assessed against key evaluation criteria which related to bid price, the certainty of completion of sale arrangements, proposed special conditions of sale and the proposed terms for the purchase of Energy Brix, either by the Hazelwood bidders or other parties.

3.8.69 In the same month, the Government announced the sale of Hazelwood to the National Power consortium, comprising:

- *National Power Australia Investments Ltd*, a subsidiary of National Power PLC which is one of the leading generation companies in the United Kingdom (51.9 per cent interest);
- *Hazelwood Pacific Pty Ltd*, a wholly-owned subsidiary of the United States-based utility Pacificorp Holdings Incorporated (19.9 per cent interest). **The parent company also controls Pacificorp Australia Holdings Pty Ltd which owns and operates Powercor Australia Limited, an electricity distribution business;**
- *Australian Power Partners CV*, a partnership based in the Netherlands and ultimately controlled by a United States-based organisation, Dow Chemicals (20 per cent interest). In February 1997, this organisation announced the sale of its international power generation assets, including its interest in Hazelwood, to a United States-based power generation company, AES Transpower;
- *CISL (Hazelwood) Pty Ltd*, a wholly-owned subsidiary of Commonwealth Investment Services Limited (6.1 per cent interest); and
- *Hazelwood Investment Company Pty Ltd*, a wholly-owned subsidiary of the Commonwealth Bank of Australia (2.1 per cent interest).

3.8.70 At the same time, the Government also announced the joint sale of Energy Brix to Lacemore Tower Pty Ltd, a company incorporated in Victoria and owned by the following entities:

- Herman Research Laboratory Limited, a company specialising in brown coal research and development (90 per cent interest). **The SECV has a 40 per cent shareholding interest in this company;** and
- Lendlease Ltd, a public company, operating in the financial and property services markets in Australia and overseas (10 per cent interest).



3.8.71 The successful bidder for Hazelwood was assessed as having the superior overall package as it exceeded alternative offers by a significant amount. In addition, it provided for funds (\$51.6 million) to be set aside to finance the costs associated with any subsequent closure of the Energy Brix business, should the new owners wish to do so, including the costs associated with demolition and site rehabilitation works, employee redundancies and the immediate funding of capital works.

3.8.72 In February 1997, a private sector accounting firm appointed to perform the responsibilities of process auditor for the sale of Hazelwood and Energy Brix, concluded that all bidders were accorded fair and equitable treatment and that tenders were evaluated and ranked fairly against the agreed selection criteria.

Sale result

3.8.73 Under the sale arrangements for Hazelwood and Energy Brix, the State received total sale proceeds of \$2.4 billion, comprising amounts relating to:

- sale of the State's interest in the net assets of the businesses (\$2.1 billion);
- repayment of outstanding business debt owed to the Treasury Corporation of Victoria (\$142 million); and
- stamp duty payable on sale transactions (\$139 million).

3.8.74 This outcome brings to \$13.8 billion the total proceeds to the State from the sale of electricity businesses (including the present value of franchise fees receivable), to the date of preparation of this Report.

3.8.75 Table 3.8K outlines the key components of the proceeds received from the sale of Hazelwood and Energy Brix.

**TABLE 3.8K
COMPOSITION OF SALE PROCEEDS
(\$million)**

<i>Details</i>	<i>Total</i>
Proceeds in excess of book value	1 571
Proceeds equal to the State's interest in the book value of the businesses	(a) 548
	2 119
Repayment of outstanding debt of the businesses	142
Stamp duty on sale transactions	139
Total proceeds	2 400

(a) Represents the SECV's interest in Hazelwood's net assets as at September 1996 (\$519 million) as disclosed in the most recent draft financial statements, and the book value of Energy Brix's net assets as at September 1996 (\$29 million).

3.8.76 The previous table shows that the State received \$2.1 billion for the sale of the net assets of Hazelwood and Energy Brix, which at the effective date of sale had a book value totalling \$548 million. Therefore, in effect the State obtained \$1.57 billion in excess of the book value of these businesses, but an amount of \$41 million has been applied or set aside by the State towards meeting certain related costs. As indicated in Table 3.8L below, **the net benefit to the State from the sale of Hazelwood and Energy Brix, after taking account of these related costs, was \$1.53 billion.**

**TABLE 3.8L
NET BENEFIT TO THE STATE
(\$million)**

<i>Details</i>	<i>Total</i>
Proceeds in excess of book value	1 571
<i>Less:</i>	
Contribution towards certain possible future Energy Brix costs (a)	31
Estimated costs of sale (b)	10 41
Net benefit to the State	1 530

(a) Under the sale arrangements, the SECV paid \$31 million to a "Closure Fund" to meet certain future expenditure which may be incurred by the purchaser of Energy Brix, mainly in respect of the demolition of the complex and the redundancy of employees.

(b) Represents the costs of sale estimated by the Department of Treasury and Finance.

3.8.77 Consistent with previous electricity business sales, the proceeds received from the sale of Hazelwood and Energy Brix were mainly applied towards the reduction of State debt.

Adequacy of sale result

3.8.78 As outlined in my previous Reports to the Parliament on the State's electricity privatisation program, the Government obtained external valuations of the electricity businesses, prior to their sale, to ensure that reasonable returns were achieved by the State from the sale of the companies.

Hazelwood

3.8.79 The proceeds of \$2.3 billion received from the sale of Hazlewood's net assets, together with stamp duty of \$139 million received by the State from the sale transaction, compared favourably with the valuations of the business provided by the Government's financial advisors in July 1996, based on the trade sale option, which were as follows:

- between \$1.2 billion and \$2 billion, based on the business sale revenue projections for the period July 1995 to June 1998;

- between \$542 million and \$1.3 billion, based on the estimated earnings of the business before interest, tax, depreciation and amortisation less capital expenditure for the period July 1995 to June 1998; and
- between \$597 million and \$1.5 billion, based on the projected earnings of the business before interest, tax, depreciation and amortisation for the period July 1995 to June 1998.

3.8.80 Table 3.8M details the sale result achieved by the State in relation to Hazelwood and Energy Brix, on the basis of price to earnings multiples, with the result achieved from the earlier sale of Yallourn Energy.

TABLE 3.8M
SALE PROCEEDS AND EARNINGS MULTIPLES
ACHIEVED FROM THE SALES (a)

<i>Details</i>	<i>Hazelwood and Energy Brix (b)</i>	<i>Yallourn Energy</i>
	<i>Price to earnings multiples</i>	
1995-96	20.1	9.7
1996-97	24.1	9.3
1997-98	13.5	8.1
1998-99	13.5	-
Average	17.8	9.0
Sale proceeds (\$m) (c)	2 261	(d) 2 146

(a) The earnings multiples are based on projected earnings before depreciation, interest, tax and abnormal items (EBDIT), as per the Information Memorandum for each company (in nominal dollars).

(b) The EBDIT for Energy Brix only represents 2 per cent of the total combined EBDIT for Hazelwood and Energy Brix for the period July 1995 to June 1999.

(c) Represents proceeds for the sale of the net assets of the businesses and the repayment of debt.

(d) This amount is \$2 million lower than that included in my *Report on the Statement of Financial Operations, 1995-96*, due to an equivalent refund by the State to the buyers of Yallourn Energy relating to an adjustment for working capital at the date of completion of sale.

3.8.81 The table shows that the price to earnings multiple achieved by the State from the sale of Hazelwood and Energy Brix was significantly greater than the result achieved for the sale of Yallourn Energy. The Department of Treasury and Finance advised that the premium paid for Hazelwood reflects the expectation by the purchasers that they will be able to substantially improve the capacity utilisation of the power station, which was projected by the State to average 43 per cent a year during the period July 1995 to June 1998. This projected utilisation rate was significantly below the equivalent average projection for Yallourn Energy of 77 per cent a year.

.....

Energy Brix

3.8.82 As mentioned previously in this Report, to ensure that Energy Brix continued to operate as a going concern, since its establishment in October 1993, the Government has provided to the company \$40.6 million in financial support, for application towards its operating costs and the update of its plant and equipment. Furthermore, upon the incorporation of Energy Brix in July 1996, the Government's equity in the business of \$17.2 million was converted to debt owed to the State. However, this debt was converted back to equity through the issue of shares with an equivalent value to the SECV immediately prior to the sale of the company.

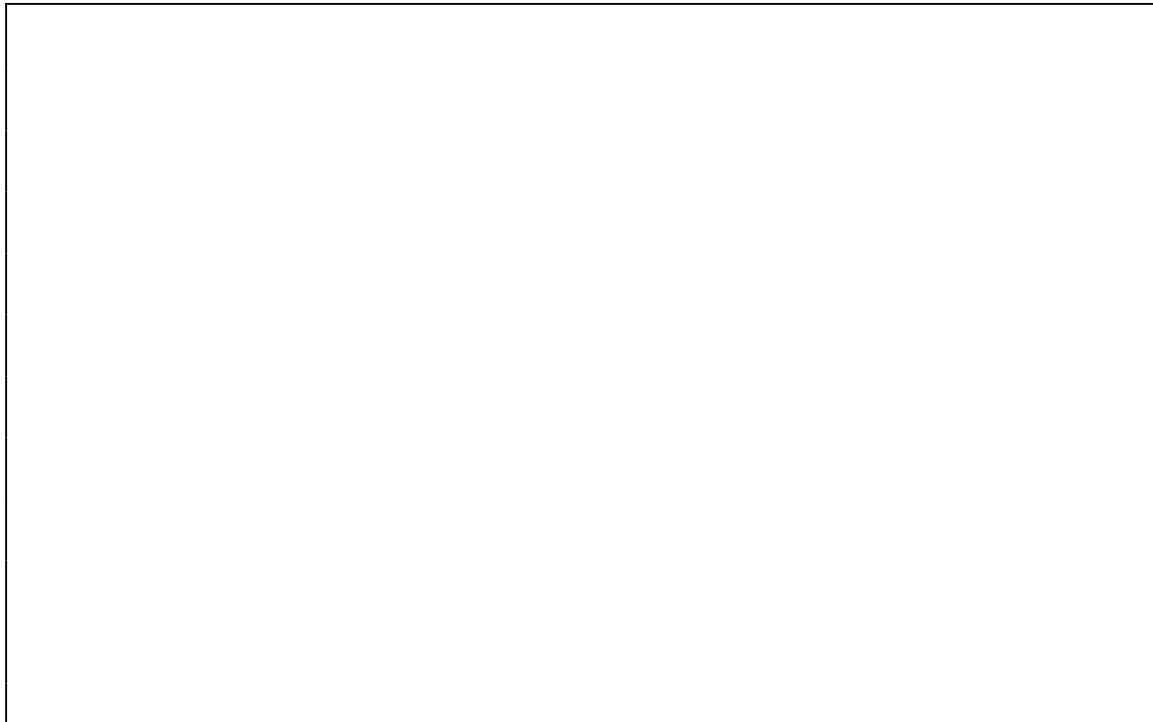
3.8.83 Under the joint sale arrangements for Hazelwood and Energy Brix, the State received \$51.6 million from the purchaser of Hazelwood to mainly fund future liabilities associated with the potential closure of Energy Brix, however, received nil consideration for the Energy Brix shares from the purchaser of Energy Brix and was required to make the following payments totalling \$42.7 million in relation to the Energy Brix business:

- \$12.1 million paid directly to the company for the purpose of funding capital works, the maintenance of plant and equipment and the payment of stamp duty under the sale arrangements; and
- \$30.7 million paid to a Closure Fund managed by a trustee company which will act as trustee of the Fund. Allocations from the Fund are to be made to meet the possible costs of demolition of the Energy Brix complex and the rehabilitation of the site, any redundancy payments to employees, and superannuation contributions to the Victorian Electricity Industry Superannuation Fund. If there is any balance in the Closure Fund after September 2009, or on a change in the control in Energy Brix, the remaining balance of the Fund is required to be transferred to the State.

3.8.84 After taking into account the above contributions by the SECV of \$42.7 million and \$40.6 million of financial support, the State has contributed to this business \$83.3 million since the 1993-94 financial year.

3.8.85 The audit analysis of the sale result achieved by the State for Energy Brix concluded that:

- The State received \$8.9 million in relation to the business, even though the reported book value of its net assets was recorded at \$28.7 million as at the date of its sale;
- The Government did not obtain an independent valuation of the business immediately prior to its sale; and
- While it may appear that the Government's decision to package the sale of the company with Hazelwood has eliminated its direct exposure to this business (and in particular in relation to its possible future closure), as the State owns 40 per cent of the current major shareholder of Energy Brix, the State still has an exposure in relation to its interest in the company.



Energy Brix complex.

What will be the ongoing impact of these 2 sales on State finances?

3.8.86 My previous Reports to the Parliament have provided an analysis of the impact of the electricity privatisation program on State finances, in terms of the net interest savings to be achieved from the repayment of State debt resulting from the sales, after taking into account revenue forgone in the form of dividends and State equivalent taxes. Table 3.8N provides an update of the estimated impact on State finances of the electricity industry privatisation program at the date of preparation of this Report.

TABLE 3.8N
PROJECTED NET SAVINGS FROM PRIVATISATION
OF ELECTRICITY BUSINESSES
 (\$million)

<i>Details</i>	<i>1996-97</i>	<i>1997-98</i>
Revenue forgone -		
Dividends (a)	231	301
State equivalent tax (b)	11	43
	242	344
Less income entitlement payments to municipal councils	(26)	(28)
	216	316
Interest savings (c) -		
Budget sector debt	576	607
SECV debt	258	258
	834	865
Net savings	618	549

- (a) Based on revenue projections contained in the Information Memorandums issued by the Government in relation to the sales and an estimate relating to United Energy Limited for 1997-98.
- (b) Provided by the Department of Treasury and Finance based on a "no privatisation" assumption.
- (c) Based on estimates of interest savings provided by the Department of Treasury and Finance, and the Treasury Corporation of Victoria. These estimates do not include interest savings relating to businesses' debt owed to the Treasury Corporation of Victoria as the impact is already taken into account in arriving at the businesses' profits upon which dividends are based.

3.8.87 As previously mentioned, the State has received \$13.8 billion from the sale of electricity businesses to date, the majority of which has been applied to the reduction of State debt which in turn has resulted in a significant reduction in interest costs. **On the basis of current government projections, it is estimated that the State will derive ongoing net savings of \$584 million a year from the electricity privatisation that has occurred as at the date of preparation of this Report.**

Obligations of the purchaser of Hazelwood

3.8.88 Under the sale arrangements, the purchaser of Hazelwood agreed not to sell a substantial part of the acquired business, except with the prior written consent of the Treasurer, for a period of 3 years from the date of sale completion. In addition, given that one member of the purchasing consortium wholly owned the electricity distribution company Powercor, certain restrictions were imposed by the State on the participation of that member in the management of the consortium to ensure that cross-ownership conflicts are avoided.

3.8.89 As a transitional arrangement to the planned establishment of the national electricity market by July 1997, the purchaser of Hazelwood also agreed to restrict the operation of the power station so that the station's generating capacity cannot exceed 89 per cent of its total potential capacity. This cap is to continue until the earlier of the commencement of the national electricity market or 30 June 1997.

Obligations of the State to purchasers of Hazelwood and Energy Brix

3.8.90 While under the sale arrangements substantial financial benefits have accrued to the State from the sale of Hazelwood, the State has provided certain indemnities and warranties to the purchaser, including an indemnity with an aggregate maximum exposure to the State of \$40 million, against a requirement for Hazelwood to pay State equivalent taxation which was not fully provided for in the financial statements in respect of the period up to the effective date of sale. Furthermore, the State retained the following specific obligations in relation to Hazelwood:

- To transfer to Hazelwood the contractual obligations of other generators which are controlled by the State, for the provision of power to South Australia under an energy export contract entered into between the State Electricity Corporation of Victoria and the Electricity Trust of South Australia. This obligation which remains in force until May 1997, has been met by the State;
- Consistent with other generators, to compensate the purchaser against certain losses of income until the year 2000, resulting from reduced electricity production caused by major industrial relations disputes which affect one-third or more of the company's generating capacity; and
- To use its best endeavours to novate to the purchaser a sale and leaseback arrangement relating to a bucket wheel excavator between Generation Victoria and a German company. The rights and obligations of this arrangement were assumed by Generation Victoria from the SECV in December 1993. However, following the disaggregation of Generation Victoria, Hazelwood has been responsible for meeting the rental and residual payments for the excavator.

3.8.91 As previously mentioned in this Report, under the Energy Brix sale arrangements, the SECV was required to make payments totalling \$42.7 million in relation to the Energy Brix business, \$30.6 million of which was paid into a Closure Fund to meet the costs of demolition of the Energy Brix complex, the rehabilitation of the site and other closure expenses. The State has provided an indemnity to the purchasers against any State Equivalent Tax payable in relation to these payments.

3.8.92 Based on advice from the Department of Treasury and Finance, the maximum amount which the purchasers can recover from the State in respect of warranties and indemnities is an amount equal to the nominal purchase price of \$2.

3.8.93 If at the end of a period of 13 years from the sale completion date, or at the date the controlling interest of Energy Brix changes (excluding the acquisition of the company by a member of the consortium which purchased Hazelwood), there remains any balance in the Closure Fund, referred to previously, such balance shall be paid to the State or be used at the State's discretion. In addition, Energy Brix is permitted up until 30 June 1999 to borrow, on an interest free basis, up to \$6 million from the Closure Fund to finance any losses in the following 3 years of operation.

Impact of government pricing directive

3.8.94 In 1981, the SECV entered into a Natural Gas Sales Agreement with ESSO and BHP for the supply of gas to its gas-fired generators, comprising the Newport and Jeeralang power stations. Following the disaggregation of the SECV, the responsibility for these power stations and the supply agreement were transferred to Generation Victoria.

3.8.95 Under the supply agreement, which expired in December 1996, Generation Victoria was supplied a minimum annual quantity of gas which was required to be paid for, whether or not it was consumed. Under the agreement, the cost of the purchase of the minimum annual quantity of gas for the 1996 calendar year was set at \$74.4 million.

3.8.96 Since the commencement of the Victorian wholesale electricity market in February 1995, Generation Victoria had been reluctant to pay for gas which it may not use, which led it to consume as much of its gas entitlement as possible and, as a result, bid very competitively against other generators competing for the supply of power in the electricity market, which contributed to a decline in the price for wholesale electricity.

3.8.97 When the Government initiated the privatisation of the first generator, Yallourn Energy Ltd, in response to concerns from potential purchasers, the Treasurer gave an undertaking that the remaining State-owned generators would operate their power stations as if they were privatised. **Given this undertaking, and Generation Victoria's market behaviour as indicated above and the potential impact on the result of future sales of generation companies, in June 1996 the Treasurer issued a directive to Generation Victoria which effectively restricted its ability to freely compete in the wholesale electricity market by specifically instructing its Board to assume a stipulated price for gas supplied under the supply agreement when submitting bids in the electricity market, until the expiry of the gas supply agreement in December 1996.** This arrangement was disclosed in the Information Memorandum for Hazelwood provided to potential bidders in June 1996.

3.8.98 Following receipt of the directive, Generation Victoria assessed the impact on its operations and determined that, **as it was unable to bid aggressively for the supply of power in the electricity market by assuming a fuel cost below the market value of gas, it would not fully utilise its gas entitlement under the gas supply agreement. Consequently, Generation Victoria was required to pay \$26 million for the unused portion of gas under the take-or-pay supply agreement.**

3.8.99 In addition to the abovementioned payment of \$26 million to ESSO and BHP for gas not consumed, the above government directive also placed Generation Victoria into an increased loss-making position in relation to its electricity trading activity for the period April to December 1996 as it was not able to competitively participate in the electricity market during this period. The extent of these losses in the period July to December 1996 were \$10.8 million.



3.8.100 In summary, the overall impact of the government directive as to the manner in which Generation Victoria was required to conduct its trading activities in the wholesale electricity market contributed in an estimated total loss of \$36.8 million to the business. However, this arrangement may have also contributed to a more favourable result to the State from the sale of Hazelwood.

Utilisation of Generation Victoria’s power stations

3.8.101 As mentioned previously, Generation Victoria operates 2 gas-fired power stations, namely Newport and Jeeralang, which have an estimated book value of \$105 million.

3.8.102 During November 1996, a legislative obligation to de-commission the power station in the year 2012 and a restriction on its generation capacity to 500 megawatts were removed to facilitate its ongoing commercial operation.

3.8.103 However, uncertainty surrounds the future utilisation levels of the Newport power station. In particular, Generation Victoria has advised that, **during the period July 1996 to March 1997, it only operated the Newport power station at an average of 7.9 per cent of total capacity, with the Jeeralang power station only operating at a 2.5 per cent utilisation rate. Accordingly, the value of Generation Victoria’s assets, namely Newport and Jeeralang power stations, which is currently estimated at \$105 million, needs to be re-assessed.**

RESPONSE provided by Secretary, Department of Treasury and Finance

Adequacy of sale result - Energy Brix

The book value of net assets of \$28.7 million referred to in the Report does not include provision for certain liabilities in relation to closure and site restoration costs. Given the probability that the State would have exited from the business at some future point had the sale not occurred and recognising that the business was unlikely to remain viable in State hands without continuing financial support, the combination of these costs should be considered in measuring the proceeds from sale to book value. This matter was highlighted in the Information Memorandum provided to prospective purchasers which contained estimates of closure costs that had not been provided for in Energy Brix’s balance sheets. Inclusion of these liabilities (approximate \$45 million) placed Energy Brix in a negative net asset position. Valuations which had been made available to government also showed a range of negative values for the business.

□ **RESPONSE** provided by Secretary, Department of Treasury and Finance

Impact of government pricing directive

The take or pay gas contract referred to in the Report was allocated from the SECV to Generation Victoria in January 1994. The presence of a major take-or-pay contract distorts the expected rational behaviour of a generator and led Generation Victoria to generate significantly more electricity than proper commercial considerations would imply. This is particularly relevant in this instance where the behaviour was a reaction to the accumulation of unused gas over the life of the contract. When the Government initiated the first generator privatisation, all potential purchasers expressed concern at possible uncommercial behaviour by the remaining publicly-owned electricity assets. The Treasurer gave an undertaking that the businesses would operate as if they were in a privatised situation.

The Direction was to give effect to a more appropriate behaviour based on incremental gas purchases at a commercial rate. The previous behaviour caused perverse market outcomes and contributed significantly to inhibiting the operation of the pool as a proper functioning market for electricity, undermining the reform process and the Treasurer's undertaking.

Because of the uncommercial nature of the take-or-pay arrangements, GenVic was always going to be in a loss-making situation on gas supply as it was unable to recover its full costs. GenVic was seeking through its bidding behaviour to mitigate the losses, however, the Government felt this was to the larger detriment of the commercial operation of the market. Irrespective of the directive, GenVic under the take-or-pay arrangements would have been required to make a sizeable payment to the supplier.

It is noted that Generation Victoria recorded a substantial profit for 1995-96 and for the first half of 1996-97.

PETROLEUM RESOURCES RENT TAX DISPUTE SETTLEMENT

3.8.104 My previous Reports to the Parliament have commented on a dispute which had developed between GASCOR and Generation Victoria, and ESSO and BHP, in relation to the Commonwealth Government-imposed Petroleum Resources Rent Tax (PRRT) on Bass Strait oil and gas production.

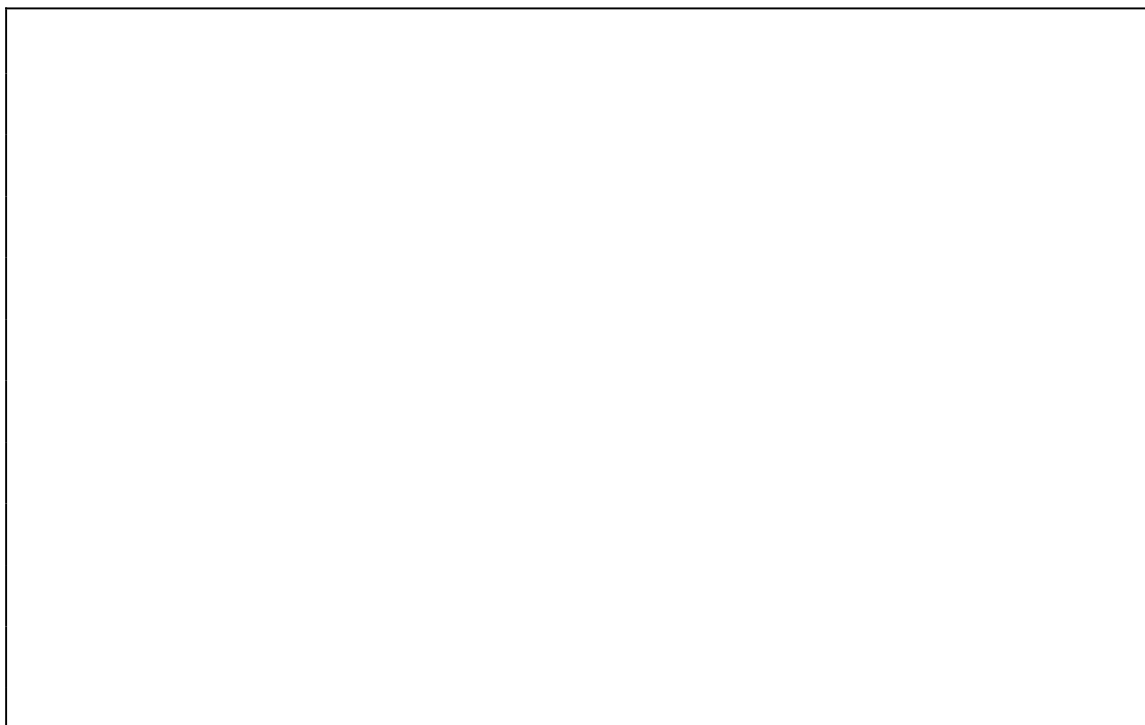
3.8.105 As previously outlined, GASCOR and Generation Victoria purchased natural gas produced from Bass Strait under supply agreements with ESSO and BHP. In turn, GASCOR supplied this gas to its industrial, commercial and domestic customers, while Generation Victoria utilised the acquired gas in the operation of its Newport and Jeeralang gas-fired power stations.

3.8.106 Prior to July 1990, the production of gas from Bass Strait was taxed in accordance with the Commonwealth Government's excise and royalty regime which attracted a 10 per cent to 12.5 per cent royalty. This royalty was paid by ESSO and BHP and was implicit in the price of gas supplied to the purchasers.



3.8.107 However, in July 1990, the Commonwealth Government introduced a PRRT on Bass Strait oil and gas production. The new tax regime imposed a 40 per cent taxation rate on the producers' taxable profit from the extraction of gas and oil. Consequently, ESSO and BHP immediately commenced invoicing the purchasers for the PRRT liability, after allowing for an amount equivalent to that which would have been paid for royalties, as they believed that the gas supply agreements with the purchasers permitted them to pass-on the PRRT relating to gas sold to the purchasers.

3.8.108 As a result of the above action, a dispute arose between the purchasers and ESSO and BHP, as the purchasers did not believe that they were liable to pay the PRRT under the existing gas supply agreements and, consequently, did not pay the amounts invoiced.



Gas pipeworks.

3.8.109 During the 1995-96 financial year, the Treasurer agreed to indemnify Generation Victoria against any PRRT liabilities arising from any adverse litigation outcome for the period up to 31 December 1996, the date of expiration of the gas supply agreement between Generation Victoria, ESSO and BHP.

3.8.110 The Government's *Statement of Financial Operations, 1995-96* included contingent liabilities of around \$625 million as at 30 June 1996 in relation to the State's PRRT exposure, comprising \$422 million for GASCOR and \$203 million for Generation Victoria. However, my October 1996 Report to the Parliament on that Statement disclosed that if ESSO and BHP were successful in passing-on the PRRT cost to the purchasers, based on estimates provided by the Department of Treasury and Finance, the State had a maximum total PRRT exposure in nominal terms of around \$3 billion (net present value of \$1.9 billion) under the gas supply agreements which were expected to conclude in 2008, excluding any interest that may be payable on outstanding amounts.

3.8.111 After years of legal dispute, in November 1996, the Government announced that the PRRT dispute had been resolved and a settlement had been agreed between the respective parties. This Report details the processes leading to the resolution of the dispute together with the settlement achieved by the State.

Negotiations prior to settlement

3.8.112 Following protracted arbitration proceedings between the respective parties, which commenced in early 1992, **the Government in early 1994 indicated a desire to seek a negotiated resolution to the dispute**, on the following major grounds:

- the dispute was seen as a major impediment to the reform of the gas market in south-east Australia;
- there was a prospect of the State receiving a windfall payment from the Commonwealth Government, in lieu of a PRRT paid to the Australian Taxation Office, if a settlement was reached;
- the chance of success with the arbitration proceedings was considered low; and
- there were high costs associated with continuing legal proceedings.

3.8.113 **In September 1994**, the Victorian Government advised the Commonwealth Government that Victoria was committed to encouraging free and fair trade in gas, however, the State's ability to fully embrace the reform process was adversely affected by the PRRT dispute. It was the State's view that there was no justification for the PRRT to be passed-on to the State and ultimately to consumers by ESSO and BHP, and that this was also not the intention of the Commonwealth Government when it introduced the PRRT. In attempting to resolve the dispute, **the Victorian Government submitted the following proposal to the Commonwealth Government:**

- The State to increase the price paid to ESSO and BHP under the gas supply agreements for gas consumed in the D market (representing all domestic, commercial and industrial customers with consumption less than 10 550 gigajoules a year), at an estimated additional cost to the State over the remaining life of the relevant agreement of about \$268 million in net present value terms. It was anticipated that there was little scope for this additional cost to be passed-on to consumers without an adverse impact on the competitiveness of the State's industry, therefore, it was expected that the impact of the higher gas prices would be predominantly or wholly offset by reduced public authority contributions from GASCOR to the Consolidated Fund;



- ESSO and BHP to terminate all past and future PRRT claims against the State;
- The Commonwealth to return to the State all the additional PRRT and company tax revenues generated from the higher D market gas price paid by the State, plus an additional 50 per cent of the net amount by which the State remained disadvantaged after receipt of the above amounts from the Commonwealth; and
- The settlement with ESSO and BHP of a number of other important contractual matters to ensure that gas reform could proceed at an acceptable pace.

3.8.114 Also in September 1994, the Victorian Government advised ESSO and BHP that it was prepared to resolve the PRRT dispute on the basis of a proposal mainly comprising an increase in the price paid for domestic market gas, the withdrawal by ESSO and BHP of all claims for PRRT pass-on and amendments to the gas supply arrangements so as to facilitate gas industry reform and enable free and fair trade in gas. Specifically, the State's offer, which was conditional on ESSO and BHP agreeing to defer current litigation and arbitration pending consideration of the offer, included:

- progressive increases in the price paid for D market gas, initially to 77 cents per gigajoule in January 1995 and ultimately increasing to \$2 dollars per gigajoule in January 2001, and a C market (for all larger commercial and industrial customers) gas price of \$2 dollars per gigajoule applicable to 2001 and subject to review thereafter;
- the PRRT not to be passed-on to the State;
- the former Gas and Fuel Corporation of Victoria (now GASCOR) and Generation Victoria to be entitled to sell gas to any party within or outside Victoria;
- Gas and Fuel's existing franchise area to be reduced as direct access is progressively introduced under the gas industry reforms; and
- Gas and Fuel's obligation to purchase gas exclusively from ESSO and BHP to be removed.

3.8.115 After considering this proposal, in October 1994, ESSO and BHP advised the Treasurer that there was insufficient common ground between the disputing parties to enable a commercial settlement of the PRRT dispute. Consequently, ESSO and BHP were not prepared to agree to any further deferment of the existing arbitration proceedings with Generation Victoria and Gas and Fuel.

3.8.116 At a subsequent meeting between the parties **in April 1995, the State made a further proposal to settle the dispute**, comprising an up-front lump sum payment to ESSO and BHP of \$290 million together with additional payments of around \$160 million in net present value terms in the form of increased D market prices as from the year 2000. The State also offered to cease deducting an amount for gas royalties when paying monthly invoices for gas received. In return, ESSO and BHP was required to no longer pass-on the PRRT to the purchasers.

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3.8.117 While this proposal was rejected, **in August 1995 ESSO and BHP provided a counter-proposal to the State** which contained the following elements:

- ESSO and BHP to be paid a lump sum amount of \$540 million in respect of gas sold to GASCOR and Generation Victoria for the period up to September 1995;
- In relation to the PRRT, as from October 1995 ESSO and BHP were prepared to accept payment over time, provided that there was certainty as to the quantity and timing of such payments. In particular, it was proposed that the D market gas price be increased to \$1.60 per gigajoule as from October 1995 and subsequently increased by 60 cents per gigajoule a year (1995 prices) as from January 1999 until the expiration of the D market contracted gas quantity under the then gas supply arrangements. In addition, the State was required to accept a minimum payment obligation for D market gas at these increased prices; and
- As from October 1995, the State to pay for C market gas in accordance with the terms of the then GASCOR gas sales agreement, without adjustment in respect of the change in tax regimes from royalty to PRRT which was effective as from July 1990.

3.8.118 The Government subsequently advised ESSO and BHP that it could not accept this counter-offer as the proposed terms of settlement were far in excess of the Government's estimates of the appropriate level of settlement. Nevertheless, **the Government issued another proposal which was substantially based on the ESSO and BHP aforementioned offer.** The State's offer under this proposal was as follows:

- payment of a lump sum amount of \$320 million to ESSO and BHP in settlement of all PRRT amounts in dispute up to December 1995;
- gradual increase in the price paid for D market gas, from 50 cents per gigajoule in January 1996 to \$2 dollars in January 2001, and an increase in the price paid for C market gas to \$2.30 per gigajoule as from January 2000 to the end of the contract; and
- ESSO and BHP to relinquish all rights to any claims for the pass-on of the PRRT, the recovery of legal costs associated with the PRRT dispute, and interest on past due PRRT amounts.

3.8.119 **In January 1996, ESSO and BHP again rejected the State's latest proposal, however, provided another counter-proposal** comprising:

- A lump-sum payment by the State to ESSO and BHP of \$580 million, for PRRT in respect of gas sold to GASCOR and Generation Victoria in the period up to December 1995;
- In relation to future PRRT, the price paid by the State for gas consumed in the D market to gradually escalate from \$1 per gigajoule in January 1996 to \$2.50 per gigajoule in January 2001 until the end of the relevant contract. The State was also to accept an annual minimum payment obligation for D market gas at the increased prices; and
- The price paid for C market gas to be set at "market bearable" values as from January 2000.



3.8.120 In the same month, the State advised ESSO and BHP that it was unable to accept the offer, however, it submitted a so-called “final” proposal for the resolution of the dispute. The proposal contained the following key elements:

- A lump sum payment of \$320 million to ESSO and BHP as settlement of all PRRT amounts in dispute up to March 1996;
- Gradual increase in the price paid for D market gas, from 50 cents per gigajoule in January 1996 to \$2 dollars in January 2001, and a price paid for C market gas of \$2.30 per gigajoule (1995 prices) with effect from January 2000 to the end of the relevant contract. In each case, the prices were to be adjusted in line with movements in the consumer price index; and
- ESSO and BHP to relinquish all rights to any claims for the pass-on of the PRRT, the recovery of legal costs associated with the dispute, and interest on previously due PRRT pass-on amounts.

3.8.121 Once more, the above proposal was rejected by ESSO and BHP. In February 1996, the Government offered to increase the lump sum payment to ESSO and BHP to \$580 million, pay a price of \$2.35 per gigajoule (1995 prices) for C market gas for the period from January 2000 to December 2004 and, from January 1996 to December 2001, make additional monthly payments with an aggregate value of \$401 million (1995 prices) for D market gas purchases. Again this offer was rejected and the parties awaited the response of the incoming Commonwealth Government. However, the election of a new Commonwealth Government in February 1996 and the State elections in March 1996 contributed to a delay in the consideration to this matter.

3.8.122 In May 1996, the State Government invited the Commonwealth Government to become involved in resolving the PRRT dispute. Consequently, in July 1996, the Commonwealth Government reiterated its willingness to return to the State, on a basis to be subsequently determined, any future windfall tax gains arising from payments made by the State to ESSO and BHP.

3.8.123 In August 1996, the State made a new offer to ESSO and BHP, which contained the following elements:

- a lump sum payment of \$580 million, and additional payments relating to gas purchased for the D market totalling \$449 million (1995 prices) paid monthly from January 1996 to December 2001;
- a price of \$2.35 per gigajoule for gas purchased for the C market for the period 2000 to 2003, escalated for movements in the consumer price index;
- market-related price reviews for the period 2004 to 2006 and for the year 2007; and
- a State commitment to a take-or-pay level of 80 per cent of a proposed annual nominated quantity of gas of 180 petajoules (one petajoule equates to one million gigajoules), adjusted for reductions of up to 15 per cent at the State’s discretion for the periods 2005 to 2007, and 2008 to 2009.

3.8.124 After all these numerous offers and counter-offers, and shortly after the August 1996 Government offer was made, an agreement was reached between the respective parties as to the terms of settlement for the PRRT dispute.

Settlement arrangements

3.8.125 In November 1996, the Government and ESSO and BHP announced that an agreement for the settlement of the long-standing PRRT dispute had been reached. The settlement arrangements between these parties and the Commonwealth Government broadly involved a net after-tax payment to ESSO and BHP, and a new gas supply agreement which superseded the previous supply arrangements between GASCOR, and ESSO and BHP. Specifically, the settlement arrangements comprised the following contractual documents and legislative enactments:

- *GASCOR settlement deed*, between the State, GASCOR, and ESSO and BHP;
- *Generation Victoria settlement deed*, between the State, Generation Victoria, and ESSO and BHP;
- *New gas agreement*, between ESSO and BHP and GASCOR, commencing on the date of settlement and effectively terminating the previous gas supply contract;
- *Deed for the return of certain tax payments*, between the State and the Commonwealth Governments;
- *Gas transportation deed*, between the State, GASCOR, and ESSO and BHP; and
- *Competition Policy (Gas Supply Contract Exemption) Regulations 1996*, which authorised certain anti-competitive activities relating to the supply of gas to GASCOR by ESSO and BHP.

3.8.126 Under the arrangements, GASCOR made gross settlement payments totalling \$1 billion to ESSO and BHP, comprising \$692 million in respect of PRRT amounts outstanding in relation to gas sold and delivered between July 1990 and October 1996, and \$327 million in respect of PRRT assessed on gas to be sold and delivered between November 1996 and the date of termination of the new gas supply agreement, which is required to occur by December 2009. Table 3.8O illustrates the composition of these gross payments to ESSO and BHP.

TABLE 3.8O
GROSS SETTLEMENT PAYMENTS TO ESSO AND BHP
((\$million))

<i>Item</i>	<i>GASCOR</i>	<i>Generation Victoria (a)</i>	<i>Total</i>
Gas sold and delivered between July 1990 and October 1996	474	218	692
Gas to be sold and delivered from November 1996 to termination of new gas supply agreement (b)	324	3	327
Gross payment to ESSO and BHP	798	221	1 019

(a) Generation Victoria's PRRT liability was allocated to GASCOR under the *Electricity Industry Act 1993* and, accordingly, all settlement payments were made on the State's behalf by GASCOR.

(b) The new gas supply agreement is to continue until the date that the agreed aggregate volume of gas to be purchased under the agreement has been satisfied, but no later than December 2009.

3.8.127 The settlement amount of \$1 billion that was paid by GASCOR was significantly less than a July 1996 Department of Treasury and Finance estimate of the maximum total PRRT exposure of the State (based on invoices received and those projected to the end of the supply period), determined on a net present value basis, of \$1.9 billion. The Department has advised that the favourable result achieved by the State was consistent with its expectations of the amount it would be required to pay ESSO and BHP had it pursued the litigation process.

3.8.128 From the gross amounts paid in settlement of the dispute, ESSO and BHP retained a net after-tax payment totalling \$392 million, after being required to pay the Australian Taxation Office an amount of \$627 million in relation to outstanding PRRT and company tax assessed on the gross settlement payment.

3.8.129 While the gross cost to the State of the settlement arrangements was \$1.1 billion, which included legal and associated costs of \$43 million mainly relating to the ongoing dispute and the associated arbitration and litigation processes, consistent with the extensive negotiations between the State and Commonwealth Governments prior to settlement, GASCOR subsequently received the sum of \$555 million from the Commonwealth Government. This amount represented a part return of the PRRT and company tax paid by ESSO and BHP as a result of settlement arrangements. Therefore, as shown in Table 3.8P, the net cost of the PRRT settlement arrangements to the State was \$502 million.

TABLE 3.8P
NET COST OF PRRT SETTLEMENT TO THE STATE
((\$million))

<i>Item</i>	<i>Amount</i>
Gross payment to ESSO and BHP	(a) 1 019
Legal and associated costs mainly related to the dispute (b)	43
Gross cost to the State	1 062
Less - Additional PRRT and company tax receipts received from the Commonwealth Government	555
Amount paid to GASCOR by ESSO and BHP in settlement of gas transportation dispute (c)	5
Net cost to the State	502

(a) Includes royalties withheld by GASCOR and Generation Victoria pending resolution of the dispute.

(b) Represents legal and associated costs incurred by the Department of Treasury and Finance, GASCOR and Generation Victoria, as advised by the respective organisations.

(c) Further comment on this matter is provided later in this Report.

3.8.130 According to the Commonwealth Department of Treasury, the payment of \$555 million to GASCOR was due to the fact that any increase in tax revenue which flowed to the Commonwealth from the PRRT settlement payments was an unintended windfall. It was always the Commonwealth's intention that PRRT would be borne by producers rather than consumers. The retention by the Commonwealth Government of \$72 million of the tax payments made by ESSO and BHP under the settlement arrangements, related to outstanding royalties included in invoices issued to GASCOR and Generation Victoria for gas sold and delivered between 1 July 1990 and 30 September 1996. It was considered that this amount did not represent a windfall gain, hence it was retained by the Commonwealth.

3.8.131 As previously indicated, further to the monetary settlement arrangements associated with the termination of the PRRT dispute, the arrangements also incorporated a renegotiated gas supply agreement between GASCOR, and ESSO and BHP. While the gas prices established under the new gas agreement are consistent with the prices incurred by GASCOR under the previous supply agreement, the major features of the new agreement were:

- an enhanced ability of the parties to deal with others in the market;
- the adoption by GASCOR of a significant take-or-pay obligation in relation to the annual nominated gas quantity it is required to consume; and
- the provision of regulative exemptions to the respective parties in order to prevent breaches of the *Trade Practices Act 1994* and the *Competition Code*.

3.8.132 Detailed comment on the key elements of the new gas supply arrangements is provided later in this Report.

3.8.133 Overall, the PRRT dispute settlement arrangements which cost the State \$502 million represented a favourable outcome for the State. However, the State has accepted a significant take-or-pay obligation in relation to the annual nominated gas quantity that GASCOR is required to consume, and has retained certain anti-competitive gas supply contractual arrangements which will remain in operation until the expiry of the new gas agreement, which will be no later than December 2009.

3.8.134 The projected impact of the PRRT settlement arrangements on the State's Budget will be to reduce revenues to the Consolidated Fund from GASCOR in relation to future dividend and State tax equivalent payments, as GASCOR will now need to apply these funds towards servicing its additional debt obligations.

3.8.135 The Department of Treasury and Finance advised that GASCOR will pay a budgeted Public Account Contribution of approximately \$322 million during 1996-97, in relation to the current financial year's operations, and has already paid dividends of \$60.6 million in October 1996 and State equivalent tax of \$20.6 million in December 1996 in relation to its 1995-96 activities. However, it will not be required to pay either dividends or State equivalent tax in 1996-97, which will have a negative impact on the Consolidated Fund of \$54.4 million.

Remaining obligations of the respective parties

3.8.136 Under the terms of the settlement, certain undertakings were provided by the relevant parties, which are discussed below.

3.8.137 The settlement arrangements were structured so as to preserve the financial position of the relevant parties, despite any change in the assessed tax liability of the transaction by the Australian Taxation Office. That is, the State has agreed to indemnify ESSO and BHP for any increase in their assessed tax, however, in turn, the Commonwealth has agreed to repay the State any amount it receives. Conversely, if the tax liability is assessed at a lower amount, then ESSO and BHP are obligated to finance the difference to the State, but the State in turn must refund an equivalent amount to the Commonwealth.

3.8.138 The State also agreed to ensure that neither GASCOR, Generation Victoria nor any successor bodies or purchasers will take any action which will result in a loss of Commonwealth revenue from income tax or PRRT arising from the payments made under the settlement arrangements. To this effect, **the State has provided an indemnity with a maximum value of \$360 million against any actions by these entities causing a loss in gross Commonwealth earnings under the settlement arrangements.**

3.8.139 The Commonwealth Government also required that, upon the privatisation of GASCOR or Generation Victoria or any successor body, including a sale of any business or part of these entities, that the relevant sale agreement will include a requirement for the purchaser to provide:

- an undertaking, for the benefit of the State, that it will not take any action resulting in a loss in Commonwealth revenue from income tax or PRRT arising from the payments made under the settlement arrangements; and
- an indemnity to the State in respect of any payment made by the State under its abovementioned indemnity to the Commonwealth.

3.8.140 The Commonwealth has agreed that its payment to the State under the settlement arrangements will not affect the level of financial assistance grants or competition payments to be made to the State under the *Agreement to Implement the National Competition Policy and Related Reforms*.

3.8.141 Finally, under the arrangements, the parties agreed to bear their own legal and associated costs for all legal proceedings. However, costs associated with the arbitration proceedings, as defined in the settlement arrangements, are to be borne as follows:

- each party to bear the costs of their appointed arbitrator; and
- in relation to all other costs associated with the proceedings, the State to bear 50 per cent of the costs, with ESSO and BHP to each bear 25 per cent of the costs.

New gas supply agreement

3.8.142 As previously outlined in this Report, as part of the dispute settlement process, GASCOR, ESSO and BHP agreed to re-negotiate the previous gas supply agreement. According to the Department of Treasury and Finance, in the negotiation process, the State sought to ensure that the relative risk positions of the parties were not substantially altered by the new gas agreement.

3.8.143 The key terms of the new gas agreement, which commenced in November 1996 and is to terminate on or before December 2009, are as follows:

- GASCOR will no longer have a monopoly over the retailing of gas, however, where ESSO and BHP make direct sales throughout Victoria, the agreement provides for adjustments to be made to GASCOR's take-or-pay obligations. In addition, ESSO and BHP will now be able to construct pipelines or contract with another party for the transportation of gas, and GASCOR will no longer be obligated to source gas exclusively from ESSO and BHP. However, as outlined later in this Report, **the new arrangements between the parties have also established certain requirements which will act to restrict the competitive behaviour of GASCOR, ESSO and BHP, and which have necessitated the granting of certain exemptions from the Government's competition policy.** Under the previous gas supply arrangements, ESSO and BHP were only able to supply gas to GASCOR and a small number of affiliates;
- GASCOR has contracted to purchase 599 petajoules of gas for the D market at 27 cents per gigajoule, and 1 768 petajoules of gas for the C market at \$2.26 per gigajoule until December 1999 and \$2.35 per gigajoule as from January 2000. These contracted quantities are equal to the remaining quantities under the previous contractual arrangements. In addition, according to the Department of Treasury and Finance, the prices payable are consistent with the previous gas supply agreement;
- The price for gas used in the commercial and industrial market will be adjusted annually for movements in the consumer price index. However, any party may seek a price review at certain times if it considers that the price is no longer a fair price. The price review must be initiated in June 2000 for the period January 2004 to December 2006, and in June 2004 for the period January 2007 to December 2009. However, the price for gas used in the D market is not to be adjusted during the term of the new agreement;



- GASCOR is entitled to acquire a maximum annual quantity of gas which is equivalent to 130 per cent of its current annual nominated quantity of 180 petajoules. However, **subject to certain specific circumstances, the annual minimum quantity (or take-or-pay level) which GASCOR must acquire is 144 petajoules of gas a year, or 80 per cent of its current annual nominated quantity.** Therefore, if GASCOR fails to purchase quantities of gas greater than this annual minimum quantity, it is required to pay ESSO and BHP an amount equal to the difference, based on C market prices.

According to the Department of Treasury and Finance, the removal of GASCOR's obligation to buy gas exclusively from ESSO and BHP has required **the acceptance by the State of this more significant take-or-pay obligation.** Under the previous arrangements, the minimum gas supply that GASCOR was required to accept or pay was equivalent to about 97 petajoules, or 47 petajoules less than the new take-or-pay obligation;

- The aggregate contracted quantities of gas that GASCOR is required to acquire (i.e. the take-or-pay levels) will be reduced by:
 - Direct sales of Gippsland Basin gas by ESSO and BHP;
 - The exercise of an option by GASCOR. However, this option can only be exercised on 2 occasions, to take effect for the periods 2005 to 2007, and 2008 to 2009. On each occasion, GASCOR is able to reduce the annual nominated quantities by 15 per cent;
- Neither party will be liable for any failure to fulfil any of their obligations under the arrangements to the extent that such failure is caused by any delay, interruption, loss or damage caused by a catastrophic event. However, the contract period is to be extended for the lost days arising from such a catastrophe;
- If a contractual default occurs and is not overcome within the nominated period, the non-defaulting party may exercise any or a combination of the following remedies, as appropriate:
 - If the default is a financial or solvency default, the agreement may be terminated. However, if the default is caused by GASCOR, the obligations of ESSO and BHP may be suspended under the agreement until the default is overcome;
 - If the default is a non-financial default which has a material adverse effect, the non-defaulting party may terminate the contract; and
 - Sue the defaulting party for damages caused by the default;
- If ESSO and BHP fail to deliver any quantity of gas that they are obligated to deliver, GASCOR is entitled to the following compensation, subject to certain limitations:
 - if GASCOR has acquired gas from another supplier, ESSO and BHP must reimburse GASCOR for any additional costs incurred by GASCOR;
 - if GASCOR does not use alternative gas supplies, ESSO and BHP are required to pay GASCOR an amount equivalent to the fixed costs incurred by GASCOR relating to the undelivered gas, including transportation capacity charges; and



- ESSO and BHP must pay an amount equivalent to the direct damages suffered by GASCOR as a result of the default, including equipment repair, shut-down and start-up costs and the cost of recovery of gas from storage;
- ESSO and BHP are entitled to pass-on the impact of any increases or decreases to PRRT. In addition, they are entitled to pass-on any future carbon or environmental taxes or any taxes imposed on the sale of gas, including consumption taxes or sales taxes; and
- In addition to all other payments due under the new agreement, GASCOR is obligated to continue its previous separate contractual obligations with ESSO and BHP. These include annual maximum daily quantity payments of around \$20 million paid in monthly instalments, adjusted for movements in the consumer price index until the year 2000. These payments are for the purpose of funding infrastructure related costs incurred to facilitate the contracted maximum daily quantity of gas.

Risk analyses of new arrangements

3.8.144 In August 1996, the Department of Treasury and Finance conducted a sensitivity analysis of the proposed new gas agreement which concluded that there is a 90 per cent probability that GASCOR's gas sales will exceed the contracted take-or-pay obligation for gas. The analysis also showed that there is a 90 per cent confidence level that GASCOR's planned maximum daily quantity requirements will be less than the contracted quantities.

3.8.145 In addition, a financial consulting firm reviewed the Government's final proposal to ESSO and BHP in August 1996 for the settlement of the PRRT dispute. The key elements of the consultant's comments on that proposal were that:

- It would be difficult to expect ESSO and BHP to accept an offer less than that made in August 1996; and
- The take-or-pay level of 80 per cent of the annual nominated gas quantity can be expected to be exceeded by the demand for gas from GASCOR. However, while this level may have relatively little effect for GASCOR as a whole, the effect could be considerably more significant for individual distributors or retailers likely to succeed GASCOR, unless appropriate arrangements were made.

3.8.146 More recently, in January 1997, at the request of the Department of Treasury and Finance, a chartered accounting firm conducted a review to quantify the financial risk to GASCOR arising from the take-or-pay component of the new gas supply agreement. In a draft report to the Department, the firm advised that, based on the available information and current expectations, the financial risk to GASCOR arising from the take-or-pay level component of the new gas agreement was minimal. However, the following key matters, the occurrence of which the Department considered unlikely, were identified which may impact on the financial risk:

- the provision of far greater alternative supplies of gas, and the arrival of these alternative supplies much earlier than currently anticipated;



- the arrival of alternative supplies of gas at costs which are much lower than those currently envisaged; and
- growth in demand for gas failing to meet expectations.

3.8.147 The audit review identified that no consideration was given by the chartered accounting firm to the potential increase in the risk position of the State which may arise if the gas supply agreement was disaggregated under a privatisation scenario, under which gains and losses of market share between retailers may influence the take-or-pay liability. However, the Department of Treasury and Finance advised that this matter was considered by the Department. Furthermore, the gas price in the analysis conducted by the chartered accounting firm was modelled on the C market gas price under the agreement. However, it was identified that extreme uncertainty existed in predicting gas prices in a competitive market.

Exemptions to competition policy

3.8.148 As previously mentioned in this Report, the PRRT settlement arrangements necessitated exemptions to be provided from the application of Part IV of the *Trade Practices Act 1994* and the *Competition Code*, as a result of a number of residual anti-competitive elements contained in the new gas supply agreement. The Commonwealth and State Governments were in agreement that the public benefit flowing from the resolution of the dispute, substantially outweighed the effect of these exemptions.

3.8.149 The exemptions have been provided through the Competition Policy (Gas Supply Contract Exemption) Regulations 1996 which were made under the *Competition Policy Reform (Victoria) Act 1995*. In effect, the Regulations provide that certain aspects of the new gas agreement, which may have the effect of substantially lessening competition, are not in breach of the *Trade Practices Act 1994* and the *Competition Code*. Such provisions include:

- joint selling of gas by ESSO and BHP;
- GASCOR cannot, except to a limited extent, acquire gas directly or indirectly from a competitor of ESSO and BHP;
- ESSO and BHP cannot supply gas, except to a limited extent, to particular persons or classes of persons;
- the new gas agreement can fix, control or maintain the price of gas to be supplied by ESSO and BHP; and
- the new gas agreement can provide for the acquisition of a volume of gas by GASCOR from ESSO and BHP, and the payment by GASCOR to ESSO and BHP for a specified volume of gas which has not been acquired (i.e. GASCOR's take-or-pay obligations).

3.8.150 These Regulations will cease to have effect in November 1997, however, prior to their expiry, legislation is to be introduced in the Parliament which will have the effect of extending the period of the exemptions enabling anti-competitive activities to the date of expiry of the new gas agreement, which will be no later than December 2009.

Gas transportation arrangements

3.8.151 The previous gas supply agreement, in addition to providing for the supply of gas by ESSO and BHP, also provided for GASCOR to transport gas for and on behalf of ESSO and BHP. However, a dispute had arisen between the parties in respect to the provision of such transportation.

3.8.152 As part of the PRRT settlement arrangements, the dispute was overcome by the parties entering into a Gas Transportation Deed which established new terms for the future transportation of gas by GASCOR for ESSO and BHP. The key terms of the deed included:

- a payment to GASCOR of \$5.2 million by ESSO and BHP for amounts previously withheld. In addition, ESSO and BHP were required to pay a capital contribution charge, in relation to the BHP Methanol Research Plant, of about \$22 500 a month up to July 1997;
- GASCOR to continue transporting gas on behalf of ESSO and BHP, including gas relating to direct sales of ESSO and BHP, through GASCOR and the Gas Transmission Corporation pipelines and facilities; and
- the transmission charges payable by ESSO and BHP for a specified volume of gas to be subject to movements in the consumer price index, with the cost of the transportation of gas in excess of this specified volume of gas to be at a reasonable tariff.

3.8.153 The Gas Transportation Deed is intended to act as an interim arrangement, pending the development of an access scheme for third parties to enable them to have access to gas transmission or distribution pipelines in Victoria.

Future gas industry reforms

3.8.154 In March 1997, the Government announced plans for the restructure of the Victorian gas industry with the aim of creating a more competitive and efficient energy sector. The planned restructure will involve the disaggregation of GASCOR into 3 retailers and 3 gas distributors, which are intended to be privatised commencing from 1998. The Gas Transmission Company will continue to own and maintain Victoria's gas pipeline infrastructure and will take on an additional role as operator of the gas transmission system.

3.8.155 The proposed retailers will purchase gas from producers, a wholesale point of distribution, or other parties who own gas. Furthermore, gas prices to consumers are to be capped below movements in the consumer price index until December 2000 and large gas consumers will be able to select the most competitive retailers and distributors as from July 1998, while domestic gas consumers will be able to participate in a fully competitive market from January 2001.

3.8.156 As part of the reform process, the Government will need to ensure that the State's exposures under the new gas supply agreement, and in particular in relation to GASCOR's take or pay obligations, are appropriately allocated to successor bodies.



REFORM OF VICTORIAN PORTS

3.8.157 In my May 1996 *Report on Ministerial Portfolios*, I provided an outline of the Government's reform program for Victorian ports, which mainly comprised:

- establishment of the *Port Reform Unit* within the Department of the Treasury and Finance to manage the reform process;
- the creation of 3 new entities through the disaggregation of the Port of Melbourne Authority (PMA), namely;
 - *Melbourne Port Corporation* - responsible for the management of all land within the Port of Melbourne;
 - *Victorian Channels Authority* - responsible for the management of navigation channels in the ports of Melbourne and Geelong, including the channels serving these ports; and
 - *Melbourne Port Services Pty Ltd* - responsible for the provision of services to shipping, including cleaning, security, mooring and maintenance;
- sale of the World Trade Centre complex and the operations and assets of the Port of Geelong Authority and the Port of Portland Authority (the results of these sales were reported in my October 1996 Report to the Parliament on the Government's Statement of Financial Operations for the 1995-96 financial year); and
- appointment of a sole Board Member who acts as an administrator to manage the residual functions of each of the PMA, the Port of Geelong Authority and the Port of Portland Authority, which were not allocated to the new entities or divested to the private sector.

3.8.158 The main objectives of the port reform program are to:

- increase port efficiency and improve services;
- reduce port costs to importers and exporters; and
- achieve a reasonable return to Victorian taxpayers from the sale of assets.

3.8.159 Accordingly, the reforms are aimed at fostering competition within Victorian ports, increasing the role of the private sector in service delivery and encouraging application of world's best practice in Victoria's port industry.

Disaggregation of the port authorities

3.8.160 As part of the disaggregation of the PMA, on 1 March 1996 net assets of the Authority amounting to \$57 million were allocated to the 3 new entities, with a further \$122 million of net assets allocated to other Government agencies, and the residual net assets of \$76 million as at 30 June 1996 remaining with the Administrator of the Authority.

3.8.161 As a part of this allocation process, port channels valued at approximately \$70 million were initially transferred to the Department of Treasury and Finance. The Department in turn revalued these assets to a nil value and transferred them to the Victorian Channels Authority. However, as these assets continue to provide a revenue earning capacity to the Victorian Channels Authority, it was considered by audit that the assets should have been appropriately valued and recorded in the books and accounts of the Victorian Channels Authority. Accordingly, the Authority's financial statements for the 1995-96 financial year were qualified on this issue.

3.8.162 The residual net assets of the ports of Geelong and Portland which were valued at \$109.3 million as at 30 June 1996, are under the management of an Administrator respectively, pending the resolution of any outstanding issues relating to the net assets and ultimately their settlement, sale or transfer. The main issue currently being addressed by the Administrator in relation to both ports is the transfer of the residual land and buildings to the Department of Natural Resources and Environment to facilitate the further transfer of their operational control to other agencies, including committees of management. It is planned by the Administrator that the majority of the residual net assets will be transferred to other government agencies by 30 June 1997.

Payment of redundancy packages

3.8.163 Since 1991, the 3 port authorities initiated various programs aimed at improving port productivity. One such program has involved the reduction of staff numbers to levels compatible with operational requirements, through the offer of redundancy packages.

3.8.164 Since that date, approximately 900 port employees have received redundancy packages at a cost to the 3 port authorities of around \$30.6 million. Further redundancy packages are expected to be provided at later stages of the reform process.

3.8.165 Details of the cost of redundancy payments made by the port authorities over the past 5 years are detailed in Table 3.8Q.

TABLE 3.8Q
REDUNDANCY PAYMENTS PAID BY THE PORT AUTHORITIES
(\$million)

<i>Authority</i>	<i>1991-92</i>	<i>1992-93</i>	<i>1993-94</i>	<i>1994-95</i>	<i>1995-96</i>	<i>Total</i>
Port of Melbourne	0.2	10.1	7.1	4.5	4.1	26.0
Port of Geelong	1.7	0.6	1.0	0.0	0.5	3.8
Port of Portland	0.2	0.0	0.2	0.1	0.3	0.8
Total	2.1	10.7	8.3	4.6	4.9	30.6



3.8.166 An audit comparison of the redundancy packages provided by the Port Authorities to their employees with those provided by the Government within the budget sector showed that the packages provided to port employees were substantially more generous. In particular, based upon the extrapolation of results from a sample of packages examined by audit, **it was identified that the redundancy packages available to port employees were on average 36 per cent higher than those available within the budget sector, with an estimated cost differential of \$8.1 million.**

3.8.167 A comparison of the packages paid to Port employees with those paid to budget sector employees is provided in Table 3.8R

**TABLE 3.8R
REDUNDANCY PACKAGES PROVIDED TO PORT
AND BUDGET SECTOR EMPLOYEES**

<i>Age group</i>	<i>Port employees</i>	<i>Budget sector employees</i>
Less than 55 years	<ul style="list-style-type: none"> • 8 weeks pay; • 2 weeks pay for every year of service (no maximum period); and • After December 1995, the following enhancement payment: <ul style="list-style-type: none"> • \$2 000 for less than 10 years service; or • \$4 000 for 10 to 14 years service; or • \$6 000 for 15 to 19 years service; or • \$10 000 for greater than 20 years service. 	<ul style="list-style-type: none"> • 4 weeks pay; • 2 weeks pay for every year of service to a maximum of 15 years service (30 weeks); and • Lump sum payment of \$10 000
Greater than 55 years	<ul style="list-style-type: none"> • 8 weeks pay; • 2 weeks pay for every year of service (no maximum period); and • After December 1995, the following enhancement payment: <ul style="list-style-type: none"> • \$2 000 for less than 10 years service; or • \$4 000 for 10 to 14 years service; or • \$6 000 for 15 to 19 years service; or • \$10 000 for greater than 20 years service. 	<ul style="list-style-type: none"> • 4 weeks pay; • 1 week pay for every year of service to a maximum of 10 years service (10 weeks); and • Lump sum payment of \$5 000

3.8.168 Audit was advised that the higher redundancy packages paid to port employees reflects the more favourable awards and agreements operating within this sector, as compared with the budget sector, and the impact of the consultative process established to reach agreement with the relevant unions. In particular, the higher redundancy packages paid to port employees reflects the Port Authorities' Redeployment, Retraining and Redundancy Package appended to the Port of Melbourne Authority Administrative Clerical Professional and Supervisory Enterprise Based Award 1993 (a federal award). The enhancement payment reflects the terms of the "Memorandum of Understanding" between the Government and the maritime unions on implementation of the reforms to Victoria's ports dated 19 December 1995, and is available only to employees made redundant as part of the current port reform process.

Future directions of port reform

3.8.169 While the reforms achieved by Government to date have been substantial, the key reforms which were in the process of implementation at the time of preparation of this Report included:

- transfer of land, for lease or community use, to the Department of Natural Resources and Environment, with operational responsibility for such land to be divested to other agencies including committees of management and Parks Victoria;
- transfer of the residual assets and liabilities of the ports at Geelong and Portland to other entities;
- the seeking of expressions of interest for the management of the Port of Hastings (part of PMA) by the private sector;
- the sale of Melbourne Port Services Pty Ltd; and
- finalisation of various employment issues.

3.8.170 Audit was advised by the Administrator that the above issues are planned to be finalised prior to the end of the 1996-97 financial year, except for outstanding legal issues.

□ **RESPONSE** provided by Sole Board Member and Administrator of the 3 ports - Melbourne, Geelong and Portland

The schedule in Table 3.8R does not disclose either the concepts of comparison or the underlying Audit Office assumptions, (including superannuation relativities). The validity and relevance of Table 3.8R are, in my view, very questionable, as is the comparison of the ports with the budget sector in respect of redundancy arrangements.

The issues mentioned in "future directions of port reform" include 2 matters of government policy (Port of Hastings and Melbourne Port Services Pty Ltd). These are not matters upon which I can comment. Other residual aspects mentioned, inter alia, are subject to legal and practical developments and will continue into the following financial year, or further.

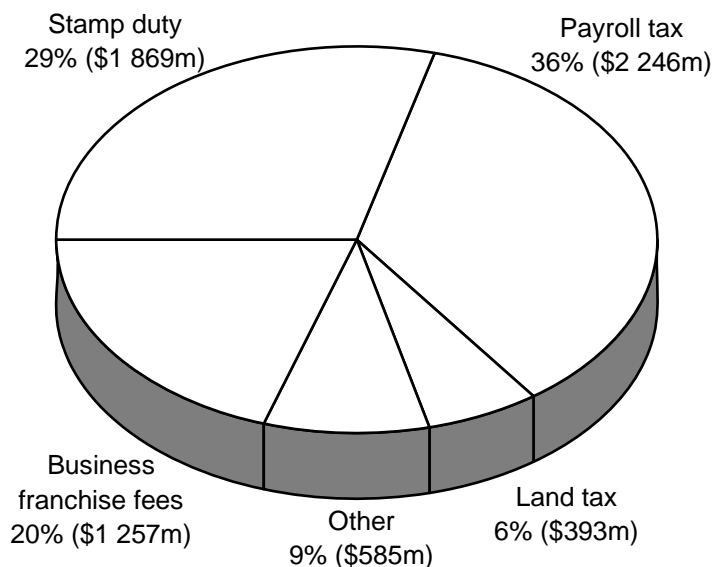
STATE REVENUE OFFICE - REVENUE COLLECTION

3.8.171 The State Revenue Office (SRO) was established in 1992 following the amalgamation of the former Stamp Duties and State Taxation Offices, and is the State's major revenue collection agency. The 3 core functions of the Office are:

- collection of State revenues;
- development of revenue and taxation policies; and
- provision of revenue management and budget information and advice to the Government.

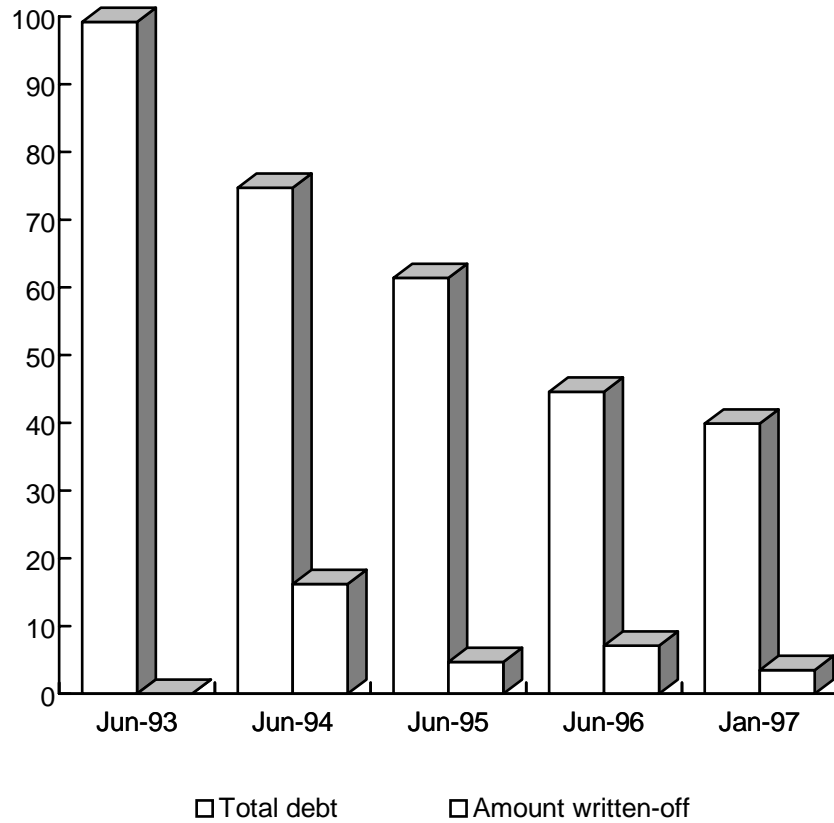
3.8.172 During the 1995-96 financial year, the SRO collected \$6.35 billion in respect to land tax, payroll tax, stamp duties, business franchise fees and other duties and levies, which represented 39 per cent of the total Consolidated Fund recurrent receipts. Chart 3.8S shows the major components of SRO revenue collections during the 1995-96 financial year.

**CHART 3.8S
SRO REVENUE COLLECTIONS, 1995-96**



3.8.173 At 30 June 1996, taxes and fees (not including penalty taxes) totalling \$44.6 million remained outstanding, which represented 0.7 per cent of annual revenue raised by SRO. Chart 3.8T shows the level of uncollected taxes and fees since June 1993 together with the value of taxes written-off by the SRO over that period.

CHART 3.8T
OUTSTANDING TAXES AND FEES, JUNE 1993 TO JANUARY 1997,
TOGETHER WITH AMOUNTS WRITTEN-OFF OVER THIS PERIOD
 (\$million)



3.8.174 The above chart shows that there has been a substantial reduction in the value of outstanding taxes and fees payable to the State, and the amounts considered unrecoverable and written-off by the SRO, over the period from 30 June 1993 to 31 January 1997. In particular, the SRO has achieved a reduction of \$59.3 million in outstanding revenues mainly through the implementation of:

- a strong focus on the collection of large value debts which were overdue in excess 30 days;
- establishment of a specific team to resolve issues relating to the collection of taxes which remained outstanding for greater than 90 days; and
- the write-off of uncollected taxes and fees of \$31.5 million.

3.8.175 An analysis of the taxes and fees outstanding, which totalled \$39.9 million at January 1997, revealed that:

- around 83 per cent of the taxes and fees were outstanding for periods greater than 90 days, with 82 per cent of that amount remaining uncollected for more than one year;
- around 1 300 cases representing \$2.8 million of the amount outstanding related to taxes raised during the period 1988 and 1993; and
- six cases representing \$17 million of the amount outstanding were the subject of protracted legal procedures and had been outstanding since 30 June 1994.

3.8.176 The positive action taken by the SRO in recent years has resulted in a substantial overall reduction in the level of uncollected taxes. However, the improvement in the level of debts outstanding for a period greater than 90 days and in particular for taxes which have remained uncollected for more than one year has been marginal, which is largely due to the impact of the 6 major cases which were the subject of protracted legal procedures.

3.8.177 During the period 1994 to 1996, the SRO wrote-off \$28 million in uncollected taxes and fees. Table 3.8U provides details of the categories of uncollected taxes and fees written-off during this period. In addition, \$3.5 million was written-off during the period July 1996 to January 1997.

TABLE 3.8U
UNCOLLECTED TAXES AND FEES
WRITTEN OFF
(\$'000)

<i>Details</i>	<i>1993-94</i>	<i>1994-95</i>	<i>1995-96</i>	<i>Total</i>
Payroll tax	8 335	3 058	4 206	15 599
Business franchise fees	5 338	212	132	5 682
Stamp duty	2 419	1 273	1 726	5 418
Land tax	129	174	339	642
Other	-	-	671	671
Total	16 221	4 717	7 074	28 012

3.8.178 The above table shows that the majority of uncollected taxes and fees written-off relate to payroll tax (\$15.6 million), business franchise fees (\$5.7 million) and stamp duties (\$5.4 million). An analysis indicates that the majority of payroll tax and franchise fee write-offs relate to uncollected taxes and fees which had been outstanding for more than one year, with business insolvency being the most common reason for such write-offs. **In respect to franchise fees, recent legislative changes have assisted the SRO to combat tax avoidance schemes which were previously in operation.**

□ **RESPONSE** provided by Commissioner of State Revenue Office

The State Revenue Office (SRO) was somewhat surprised that Debt Management was selected by the Auditor-General's Office for a section 15 audit when even a cursory examination of its performance, let alone a comparison with all other Tax Offices in Australia, would clearly indicate an outstanding achievement. The level of uncollected tax debt has been reduced from \$155.8 million in June 1992 to \$44.6 million in June 1996, representing a 0.78 per cent of all revenue collected.

The SRO is very disappointed that this achievement is given inadequate prominence in the Auditor-General's Report.

This disappointment is compounded by the present requirement that agencies pay for such audits, even when in their view the audit is not warranted on demonstrable factual evidentiary grounds and when positive findings are not adequately reported.

LOSSES, THEFTS AND IRREGULARITIES

3.8.179 A number of losses of cash, stores and plant and equipment were reported to audit by entities within the Treasury and Finance portfolio. The more significant of these losses were:

- *Power Net Victoria* - Tractor valued at \$80 000 stolen. Police investigations failed to recover the tractor;
- *GASCOR* - A number of computers and a printer, valued in total at \$31 000, stolen from the Clayton Centre. The loss is the subject of criminal charges;
 - Misappropriation of \$10 500 cash from Gasmart Ballarat;
- *Loy Yang Power Ltd* - Two incidents relating to the loss of cable valued at \$25 000 from the dredger erection site compound. Matter has been reported to the police;
- *State Trustees* - Client funds totalling \$82 380 had been fraudulently used by a former employee of State Trustees for the purchase of a motor vehicle and for other purposes such as travel arrangements. State Trustees has recovered all of the funds excluding \$3 360. All client accounts have been corrected and recredited with principal and interest; and
 - A borrower defaulted on a secured loan from the State Trustees Common Fund No. 2 with a principal sum of \$720 000. State Trustees exercised its right as mortgagee and sold the security to the loan. The amount realised on settlement was \$226 455. State Trustees has commenced legal action against the guarantors of the borrower and the valuer involved in valuing the security for the loan.



**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

GAS AND FUEL CORPORATION OF VICTORIA

<p><i>Ministerial Portfolios, May 1994, pp. 189-91.</i></p> <p><i>Ministerial Portfolios, May 1995, pp. 27-9.</i></p>	<p>After protracted negotiations extending over 4 years to determine the most suitable building for its head office requirements, the Corporation repudiated the agreement to lease entered into with Gleem Pty Ltd. This resulted in the issue of Supreme Court proceedings against the Corporation claiming damages totalling \$107 million.</p>	<p>Settlement of the dispute occurred in September 1996. No payments were made by any party to the proceedings and each party agreed to bear its costs of the litigation.</p>
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GASCOR

<p><i>Ministerial Portfolios, May 1995, pp. 31-4.</i></p>	<p>Over the life of the current gas supply arrangements, GASCOR and Generation Victoria have substantial exposure for petroleum rent resource tax if a court ruling was made entirely in favour of the gas suppliers, ESSO and BHP.</p>	<p>The petroleum rent resource tax dispute between GASCOR and Generation Victoria and ESSO and BHP was settled in November 1996. Refer to further comments on this issue in this Section of the Report.</p>
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VICTORIAN FUNDS MANAGEMENT CORPORATION

<p><i>Ministerial Portfolios, May 1996, p. 300.</i></p>	<p>The effective implementation of various initiatives aimed at improving the Corporation's performance will be vital to its ongoing viability and to the achievement of cost-efficiencies to the public sector from centralised funds management.</p>	<p>While the Corporation's client base and investment portfolio had not significantly increased since the date of the previous audit review, various initiatives had been introduced with the aim of improving the efficiency and effectiveness of its operations, and to establish a track record in funds management.</p>
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NO ACTION TAKEN

DEPARTMENT OF TREASURY AND FINANCE

<p><i>Ministerial Portfolios, May 1996, pp. 335.</i></p>	<p>There is a need for clarification within the Government's supply guidelines of the classification of consultancy and contractor services, in order to improve the disclosure of consultancy payments to the Parliament.</p>	<p>The Victorian Government Purchasing Board reviewed the classification of consultancy and contractor services within the supply guidelines, however, the Board decided against amending the guidelines.</p>
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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Department of Treasury and Finance	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	15 Oct. 1996	16 Oct. 1996
FINANCE				
Coal Mine Workers' Pensions Fund	30 June 1996	" "	16 Oct. 1996	18 Oct. 1996
Emergency Services Superannuation Board	30 June 1996	" "	25 Sept. 1996	25 Sept. 1996
Holmesglen Constructions Superannuation Plan	Period 1 July 1995 to 31 Mar. 1996	" "	27 Sept. 1996	27 Sept. 1996 (a)
Hospitals Superannuation Board	30 June 1996	" "	25 Sept. 1996	14 Oct. 1996
Local Authorities Superannuation Board	30 June 1996	" "	25 Sept. 1996	30 Sept. 1996
Parliamentary Contributory Superannuation Fund	30 June 1996	" "	10 Oct. 1996	15 Oct. 1996
Port of Geelong Authority Superannuation Fund	30 June 1996	" "	8 Nov. 1996	25 Nov. 1996
Regulator-General, Office of the	30 June 1996	" "	1 Oct. 1996	9 Oct. 1996
State Casual Employees Superannuation Fund	Period 1 July 1995 to 31 Mar. 1996	" "	27 Sept. 1996	27 Sept. 1996 (a)
State Employees Retirement Benefits Fund	Period 1 July 1995 to 31 May 1996	" "	27 Sept. 1996	27 Sept. 1996 (b)
State Superannuation Fund	30 June 1996	" "	27 Sept. 1996	27 Sept. 1996
Transport Superannuation Fund	Period 1 July 1995 to 31 May 1996	" "	27 Sept. 1996	27 Sept. 1996 (a)
Victorian Superannuation Board	30 June 1996	" "	27 Sept. 1996	27 Sept. 1996
Victorian Superannuation Fund	30 June 1996	" "	27 Sept. 1996	27 Sept. 1996
Victorian WorkCover Authority	30 June 1996	" "	15 Sept. 1996	7 Oct. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
FINANCE - continued				
Water Industry Superannuation Fund	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	27 Aug. 1996	27 Aug. 1996 (a)
Water Industry Superannuation Fund Pty Ltd	Period 4 Aug 1995 to 1 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	24 Sept. 1996	30 Sept. 1996
GAMING				
Tattersall Gaming Machine Division	30 June 1996	31 Oct. <i>Gaming Machine Control Act 1991</i> , s.132.	7 Nov. 1996	7 Nov. 1996
Tattersall Sweep Consultation	30 June 1996	<i>Tattersall Sweep Consultation Act 1958</i> .	28 Oct. 1996	30 Oct. 1996
Tattersall's Club Keno	30 June 1996	31 Oct. <i>Club Keno Act 1993</i> , s.10.	28 Oct. 1996	30 Oct. 1996
Victorian Casino and Gaming Authority	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	17 Sept. 1996	17 Sept. 1996
TREASURER				
Alufin Pty Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	30 Sept. 1996	30 Sept. 1996
Aluminium Smelters of Victoria Pty Ltd	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
Aluvic Aerospace Pty Ltd	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996 (d)
Aluvic Castings Pty Ltd	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
Aluvic Metal Sales Pty Ltd	Period 1 Dec 1995 to 30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
Alupac Pty Ltd	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
Citipower Limited	Period 1 July 1995 to 30 Sept. 1995	31 Jan. <i>Financial Management Act 1994</i> , s.53A.	29 Nov. 1996	10 Dec. 1996 (e)
Eastern Energy Ltd	Period 1 July 1995 to 30 Sept. 1995	" "	14 May 1996	29 May 1996 (e)

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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
<i>TREASURER - continued</i>				
Ecogen Energy Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	1 Nov. 1996	1 Nov. 1996
Electricity Services Victoria	30 June 1996	" "	12 Sept. 1996	18 Sept. 1996
Energy Brix Australia Corporation	Period 1 July 1995 to 14 July 1996	" "	17 Oct. 1996	17 Oct. 1996 (f)
Energy Brix Australia Corporation Pty Ltd	Period 15 July 1996 to 13 Sept. 1996	13 Jan. <i>Financial Management Act 1994</i> , s.53A.	20 Mar. 1997	20 Mar. 1997 (g)
Everton Dell Pty Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	9 Sept. 1996	10 Sept. 1996
Gas and Fuel Corporation Superannuation Fund	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	16 Oct. 1996	16 Oct. 1996
Gas Transmission Corporation	30 June 1996	" "	21 Aug. 1996	22 Aug. 1996
GASCOR	30 June 1996	" "	22 July 1996	22 July 1996
Generation Victoria	30 June 1996	" "	23 Oct. 1996	23 Oct. 1996
Hazelwood Power Corporation Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	22 Aug. 1996	27 Aug. 1996.
Hazelwood Power Corporation Ltd	Period 1 July 1996 to 13 Sept. 1996	13 Jan. <i>Financial Management Act 1994</i> , s.53A.	7 May 1997	7 May 1997 (g)
Holding Trust	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	21 Aug. 1996	21 Aug. 1996
Loy Yang B Power Station Pty Ltd	30 June 1996	" "	23 Aug. 1996	23 Aug. 1996 (h)
Loy Yang Power Ltd	30 June 1996	" "	29 Aug. 1996	29 Aug. 1996
National Electricity Pty Ltd	30 June 1996	" "	22 Aug. 1996	22 Aug. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
TREASURER - continued				
Opalwood Pty Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	21 Aug. 1996	21 Aug. 1996
Portland Smelter Unit Trust	Period 1 July 1995 to 30 Nov 1995	" "	30 Sept. 1996	30 Sept. 1996
Port of Geelong Authority	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	27 Sept. 1996	27 Sept. 1996
Port of Melbourne Authority	30 June 1996	" "	26 Sept. 1996	26 Sept. 1996
Port of Portland Authority	30 June 1996	" "	30 Sept. 1996	30 Sept. 1996
Powercor Australia Ltd	Period 1 July 1995 to 30 Sept. 1995	31 Jan. <i>Financial Management Act 1994</i> , s.53A.	27 Aug. 1996	28 Aug. 1996 (i)
PowerNet Victoria	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	27 Aug. 1996	27 Aug. 1996
Rehabilitation Holdings Pty Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	23 Aug. 1996	23 Aug. 1996
Rural Finance Corporation	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	4 Sept. 1996	4 Sept. 1996
Securities Finance Corporation Ltd	31 Dec. 1996	30 April. <i>Financial Management Act 1994</i> , s.53A.	2 Apr. 1996	2 Apr. 1996
Solaris Power Ltd	Period 1 July 1995 to 30 Sept. 1995	31 Jan. <i>Financial Management Act 1994</i> , s.53A.	19 Sept. 1996	23 Sept. 1996 (i)
Southern Hydro Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	6 Sept. 1996	6 Sept. 1996
Southgate Control Limited	30 June 1996	" "	21 Aug. 1996	21 Aug. 1996
Southgate Hotel Management Pty Ltd	30 June 1996	" "	21 Aug. 1996	21 Aug. 1996

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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
TREASURER - continued				
Southgate Trust	30 June 1996	31 Oct. <i>Financial Management Act 1994,</i> s.53A.	21 Aug. 1996	21 Aug. 1996
State Electricity Commission of Victoria	30 June 1996	31 Oct. <i>Financial Management Act 1994,</i> s.46.	19 Sept. 1996	20 Sept. 1996
State Insurance Office	Period 1 July 1995 to 30 Sept. 1996	31 Jan. <i>Financial Management Act 1994,</i> s.46.	18 Feb. 1997	26 Feb. 1997 (j)
State Trustee Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994,</i> s.53A.	1 Oct. 1996	9 Oct. 1996
STL Financial Services Ltd	30 June 1996	" "	1 Oct. 1996	9 Oct. 1996
STL Financial Services Ltd	Period 10 Oct. 1995 to 30 June 1996	" "	1 Oct. 1996	9 Oct. 1996
TAC Property Investments Pty Ltd	30 June 1996	" "	21 Aug. 1996	21 Aug. 1996
The Albury Gas Company Ltd	30 June 1996	" "	22 July 1996	22 July 1996
Transport Accident Commission	30 June 1996	31 Oct. <i>Financial Management Act 1994,</i> s.46.	10 Sept. 1996	10 Sept. 1996
Treasury Corporation of Victoria	30 June 1996	" "	6 Sept. 1996	6 Sept. 1996
Tricontinental Australia Ltd	31 Dec. 1996	30 April <i>Financial Management Act 1994,</i> s.53A.	2 Apr. 1997	2 Apr. 1997
Tricontinental Corporations Ltd	31 Dec. 1996	" "	2 Apr. 1997	2 Apr. 1997
Tricontinental Holdings Ltd	31 Dec. 1996	" "	2 Apr. 1997	2 Apr. 1997
Twin Waters Resorts Pty Ltd	31 Dec. 1996	" "	2 Apr. 1997	2 Apr. 1997
V.E.I. Super Pty Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994,</i> s.53A.	27 Sept. 1996	27 Sept. 1996
Vicfleet Pty Ltd	30 June 1996	" "	19 Aug. 1996	10 Oct. 1996

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
TREASURER - continued				
Victorian Channel Authority	Period 1 Mar. To 30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	27 Sept. 1996	30 Sept. 1996
Victorian Rehabilitation Centre Pty Ltd	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	23 Aug. 1996	23 Aug. 1996
Victorian Electricity Industry Superannuation Fund	30 June 1996	31 Oct. <i>Financial Management Act 1994</i> , s.46.	27 Sept. 1996	27 Sept. 1996
Victorian Funds Management Corporation	30 June 1996	" "	15 Sept. 1996	15 Sept. 1996
Victorian Power Exchange	30 June 1996	" "	22 Aug. 1996	22 Aug. 1996
Vistel Ltd	30 June 1995	31 Oct. <i>Financial Management Act 1994</i> , s.53A.	25 Oct. 1996	28 Oct. 1996
Yallourn Energy Ltd	Period 1 July 1995 to 29 Feb. 1996	30 June <i>Financial Management Act 1994</i> , s.53A.	29 July 1996	31 July 1996 (k)

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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
INCOMPLETE AUDITS				
GAMING				
Tabcorp Holdings Limited Club Keno Business Segment	15 Aug. 1994 to 30 June 1995	31 Oct. <i>Club Keno Act</i> 1993, s.10.	Awaiting signed set of financial statements.	
Tabcorp Manager Pty Ltd Gaming Business Segment (l)	15 Aug. 1994 to 30 June 1995	31 Oct. <i>Gaming Machine Control Act</i> 1991, s.132.	Doubt exists as to whether financial statements meet requirements of the <i>Gaming Machine Control Act</i> 1991.	
Totalizator Agency Board	1 Aug. 1994 to 2 June 1995	31 Oct. <i>Financial Management Act</i> 1994, s.46.	Awaiting signed set of financial statements.	
TREASURER				
Utilities Insurance Company Pty Ltd (m)	1 July 1995 to 31 Mar. 1996	31 July <i>Financial Management Act</i> 1994, s53A.	Audit substantially completed but awaiting signed accounts.	

- (a) Plan ceased on 31 March 1996, members' funds transferred to Victorian Superannuation Fund.
 (b) Fund ceased on 31 March 1996, members' funds transferred to State Superannuation Fund.
 (c) Formerly known as Melbourne Water Corporation Superannuation Fund.
 (d) Formerly Aluvic Services Pty Ltd.
 (e) Sold to private entity as at 30 September 1995.
 (f) Corporatised and name changed to Energy Brix Australia Corporation Pty Ltd on 15 July 1996.
 (g) Sold to private sector entity as at 13 September 1996.
 (h) Sold to private sector entity in May 1997.
 (i) Sold to private sector entity as at 30 September 1995.
 (j) Ceased operations on 30 September 1996. Activities transferred to Victorian Managed Insurance Authority.
 (k) Sold to private sector entity as at 29 February 1996.
 (l) TABCORP Manager Pty Ltd is the operator of the Gaming Licence issued to TABCORP Holdings Ltd.
 (m) Sold to private sector entity as at 31 March 1996.

Part 4



Broad Scope Issues



Part 4.1

Corporate governance in the public sector

KEY FINDINGS

- Within the public sector, there has been a significant acknowledgment of the desirability of making public sector boards more directly accountable for organisational strategic direction and operating and financial outcomes.
Paras 4.1.1 to 4.1.18
- Consideration should be given to the introduction of a requirement for all public sector agencies to disclose within their annual reports a statement of the main corporate governance practices, similar to that required in the private sector.
Paras 4.1.14 to 4.1.18

CORPORATE GOVERNANCE IN THE PUBLIC SECTOR

4.1.1 Corporate governance comprises a range of processes established within organisations to promote greater corporate accountability. In this context, the responsibility for maintaining an adequate level of corporate governance normally rests with an organisation's board of directors which, in discharging its responsibilities, should be satisfied that the organisation has appropriate control mechanisms in place to ensure compliance with all relevant regulatory requirements and that management performs its functions in a responsible and ethical manner.

4.1.2 This part of the Report reviews the application of corporate governance principles and practices within the Victorian public sector, which is particularly important in light of the Government's extensive reform program.

Impact of public sector reforms

4.1.3 The introduction of the *State Owned Enterprises Act* 1992 and subsequent legislative changes have provided the basic legal framework which, over the past 5 years, has enabled the restructuring of certain agencies along commercial lines. In a number of cases, particularly in the electricity and water industries, significant reform has been introduced which has involved the restructuring of public bodies and the re-allocation of their assets and liabilities into new State-owned corporations. This restructuring has in the majority of instances been accompanied by a greater focus on corporate accountability.

4.1.4 In particular, the boards of State-owned corporations are required to prepare statements of corporate intent, which outline agreements reached between the boards and the Government on strategic matters and targets to be achieved over a 3 year period. Such organisations are also required to prepare annual corporate plans which must be approved by their boards and submitted to their responsible Ministers and the Treasurer by no later than the 31 May of each year. Furthermore, such organisations are required to prepare interim half-yearly financial reports, which are similar to the half-yearly reporting requirements of listed public companies, for submission to, and monitoring by, the Department of Treasury and Finance.

4.1.5 **The corporatisation of agencies under the Government's reform program has established an accountability framework, which clearly delineates between the respective roles of responsible Ministers, the board of directors and executive management without impeding the responsibility for their day-to-day management and operation.**

Guidance by central agencies

4.1.6 The State's 2 key central agencies, namely the Department of Treasury and Finance and the Department of Premier and Cabinet have been instrumental in providing guidance in recent years on corporate governance matters, for application by government departments and public authorities. Some of the key areas covered by this guidance are outlined below.

Boards of Management

4.1.7 In June 1992, the Department of Treasury and Finance issued a document entitled *Guidelines for Members of Public Sector Boards* which sought to provide general guidance on best practices to be adopted by board members in the discharge of their duties and responsibilities. These guidelines, which were re-issued in June 1993, acknowledge the accountability relationship which should exist between public sector boards and their responsible Minister. Under the guidelines, board members are required to properly discharge their fiduciary duties as well as exercise proper skill and care when performing their responsibilities, in a similar fashion to their counterparts in the private sector.

4.1.8 A further initiative has been the issue, in September 1994, by the Department of Premier and Cabinet of *Guidelines for the Appointment and Remuneration of Part-time Non-Executive Directors of State Government Boards and Members of Statutory Bodies and Advisory Committees*. These guidelines outline the required policies and procedures to be applied by a number of government agencies when appointing and remunerating board members.

4.1.9 While the above guidelines are not binding on certain appointments made to school councils, university councils and hospital (health care network) boards, agencies in these categories are nevertheless encouraged to abide by the spirit of the guidelines so as to ensure that such appointments are made on the basis of merit, due process is observed in the selection process and the remuneration reflects market and work values.

4.1.10 **Audit considers that both these guidelines serve to ensure that board members properly discharge their duties and that appropriate standards of propriety, merit and equity are maintained when individuals are appointed to public sector boards.**

Audit committees

4.1.11 Audit committees play an important role in enhancing financial accountability and monitoring the performance of agencies by providing governing boards with a mechanism to better consider accounting and auditing issues, promote improved communication with external auditors, and strengthen the credibility of published financial reports. In May 1996, the Auditor-General's *Report on Ministerial Portfolios* commented on the requirements which exist in the Ministerial Directions under the *Financial Management Act 1994* for the establishment of audit committees by departments.

4.1.12 In particular, audit reported that all departments and most major public bodies had established audit committees and that most of these committees functioned in accordance with formally approved charters which outlined their duties and responsibilities. However, it was also found that departmental audit committees mainly comprised the executive management of departments, with only minimal external representation. This position is largely unchanged since last year.

4.1.13 It is particularly disappointing that at the State's lead central agency, namely the Department of Treasury and Finance, the audit committee is chaired by a senior officer holding a line management operational position, an area which should be subject to scrutiny by the committee.

Annual reporting

4.1.14 Previous Reports to the Parliament on Ministerial Portfolios have recognised the Government's initiatives to promote greater accountability through the introduction of requirements for agencies to disclose details of related party transactions in their annual financial reports. **The mandatory disclosure of such information by public sector agencies (other than municipal councils for which comment is made earlier in this report) acts to strengthen the level of accountability.**

4.1.15 More recently, an accounting and financial reporting bulletin was issued by the Department of Treasury and Finance in July 1996, which requires departments and public bodies to include a *compliance index* in their annual reports. The purpose of this index is to promote compliance by those agencies with their various statutory reporting obligations.

4.1.16 An examination by audit of the annual reports of all departments and a number of the more significant public bodies revealed that the requirement to include the compliance index was generally followed by such agencies. However, the nature and extent of disclosure varied significantly. **In the main, such disclosures provided only general information to the users of annual reports on various financial reporting compliance matters, rather than serving as a comprehensive disclosure mechanism that specifically addresses broader corporate governance issues.**

4.1.17 By way of comparison with the private sector, the Australian Stock Exchange Listing Rules require listed public companies to include in their annual reports, a statement of the main corporate governance practices which were in place during the financial reporting period. In this context, the corporate governance information which is disclosed includes the identification of significant risk management strategies, details of audit committee objectives and composition, and policies on ethical standards.



4.1.18 In the Victorian public sector, there has been a significant acknowledgment of the desirability of making public sector boards more directly accountable for an organisation's strategic direction and operating and financial outcomes. Recent developments in corporate governance provide a sound foundation for the application of these principles to all public sector agencies. In this context, consideration should be given to the introduction of a requirement for all public sector agencies to disclose within their annual reports a statement of the main corporate governance practices, similar to that required in the private sector.

□ *RESPONSE* provided by Secretary, Department of Treasury and Finance

With respect to the impact of public sector reforms on corporate governance, greater recognition should be given to the significant initiative Victoria has taken in relation to the disclosure of certain related party transactions and the remuneration of board members, Ministers and senior executives of all entities. This step sets a standard yet to be implemented by any other State or the Commonwealth.

The chairperson of the Department of Treasury and Finance's audit committee is responsible for a whole-of-government operation and has limited line responsibility within the Department. The chairperson has an extensive background of senior executive management experience in the private sector, which is considered a benefit for the role, outweighing any perceived conflict of interest.

Audit's suggestion for a separate statement of the main corporate governance practices within annual reports of all public sector agencies is reasonable and will be taken under consideration for practical implementation.

Part 4.2

Public sector financial reporting

KEY FINDINGS

- There remains a continuing need for the Department of Treasury and Finance to ensure that appropriate guidance is available within the public sector to address contentious and emerging financial reporting issues.
Paras 4.2.3 to 4.2.7
- The implementation of whole-of-government reporting for the 1996-97 financial year will require a greater emphasis on ensuring improved consistency in financial reporting across the entire public sector.
Para. 4.2.7
- For the 1995-96 financial year, the Ministerial Directions issued under the *Financial Management Act* 1994 did not have a mandatory status for the vast majority of public bodies and consequently the reporting requirements contained therein did not have to be complied with in respect of these public bodies.
Paras 4.2.8 to 4.2.10
- The Department of Treasury and Finance needs to investigate the reasons for the delays in the completion of the annual financial reporting process within the public sector and, where appropriate, take action to ensure that statutory deadlines are complied with by both departments and public bodies.
Paras 4.2.11 to 4.2.14

PUBLIC SECTOR FINANCIAL REPORTING

4.2.1 In my May 1996 *Report to the Parliament on Ministerial Portfolios*, comment was made on the impact on agencies of the new financial reporting disclosure requirements prescribed under the *Financial Management Act 1994*. In particular, it identified that the current requirements relating to the form and contents of financial statements are less prescriptive than those included in the predecessor legislation, namely the *Annual Reporting Act 1983*. While the approach taken under the *Financial Management Act 1994* to financial reporting is broadly consistent with that adopted in the private sector, audit expressed concern that the reduced level of disclosure required under that Act could lead to diminished accountability to the Parliament.

4.2.2 This Report revisits the above issue, as well as other financial reporting issues, in particular, the enforceability of the Ministerial Directions under the *Financial Management Act 1994* and the timeliness of financial statements prepared and tabled in the Parliament.

Form and content of financial statements

4.2.3 The financial reporting requirements for public sector agencies are set out in the *Financial Management Act 1994* and the Directions of the Minister for Finance made under that Act (hereafter referred to as the Ministerial Directions). In particular, section 45 of the Act requires the preparation, by departments and public bodies, of an annual report which comprises a report of operations and audited financial statements.

4.2.4 The main thrust of the Ministerial Directions on financial reporting is that agencies are required to prepare financial statements on an accrual basis of accounting and comply with Australian Accounting Standards and other mandatory professional pronouncements issued by the Australian professional accounting bodies. Furthermore, agencies are also required to comply with accounting policy papers issued by the Department of Treasury and Finance within the ambit of the Ministerial Directions.

4.2.5 In addition to the above, some departments have issued separate guidance material, including illustrative financial statements, for use by agencies within their Ministerial portfolios. The guidance material has been designed to provide added assistance to preparers of financial statements.

4.2.6 Notwithstanding the less prescriptive approach to financial reporting under the *Financial Management Act 1994*, there has been a reduction in the number of contentious accounting issues which have been reported by audit in recent years, as evidenced by the lower number of audit qualifications on financial statements of public sector agencies. The main contentious issues for the 1995-96 financial year related to the non-consolidation of controlled entities and the non-valuation of cultural assets.



4.2.7 There remains a continuing need for the Department of Treasury and Finance to ensure that appropriate guidance is available within the public sector to address contentious and emerging financial reporting issues with a view to enhancing the overall quality of financial information provided in annual reports of public sector agencies. The implementation of whole-of-government reporting for the 1996-97 financial year will require greater emphasis on ensuring improved consistency in financial reporting across the entire public sector.

Applicability of Ministerial Directions

4.2.8 Section 59 of the *Financial Management Act* 1994 allows for the Governor-in-Council to create Regulations under that Act to facilitate economic, effective and efficient financial management within the Victorian public sector.

4.2.9 To give effect to the Ministerial Directions referred to previously, the *Financial Management Regulations* 1994 serve as the legal nexus between the Directions and the Act. The Regulations explicitly state that they apply to both departments and authorities which are prescribed under the Regulations. **However, as only a small number of authorities have been prescribed under the Regulations, the Ministerial Directions do not have a mandatory status for the vast majority of public bodies and, consequently, this has led to a situation where the reporting requirements contained in the Ministerial Directions are not legally enforceable in respect of these public bodies.**

4.2.10 The Department of Treasury and Finance has advised that it intends to amend the Regulations to ensure the application of the Ministerial Directions to all public sector agencies in respect of the preparation of financial statements for the year ending 30 June 1997. At the date of preparation of this Report, the relevant amendments had not been effected.

Earlier financial reporting deadlines

4.2.11 Under the *Financial Management Act* 1994, as from the 1995-96 financial year, all financial statements that are required to be prepared under that Act are to be submitted to the Auditor-General within 8 weeks after the end of the financial year. The *Audit Act* 1994 then requires these financial statements to be audited within 4 weeks of their receipt by the Auditor-General. To complete the accountability process under the legislation, the annual reports of departments and authorities are to be tabled by the relevant Ministers in the Parliament within 4 months after the end of the relevant financial year. Where this latter requirement is not achieved, the reasons underlying the non-compliance are required to be reported to the Parliament.

4.2.12 In respect of departments for the 1995-96 financial year, audit found that the requirements of the *Financial Management Act* 1994 were met in relation to the tabling of their annual reports in the Parliament, but not in relation to the finalisation of the preparation of their financial statements. Table 4.2A illustrates this position.

TABLE 4.2A
KEY ACCOUNTABILITY DATES FOR DEPARTMENTS, 1995-96 FINANCIAL YEAR

<i>Department</i>	<i>Financial statements signed by Department</i>	<i>Audit opinion signed by Auditor-General</i>	<i>Annual report tabled in Parliament</i>
Education	26 September 1996	27 September 1996	31 October 1996
Human Services	30 September 1996	16 October 1996	31 October 1996
Infrastructure	8 October 1996	11 October 1996	31 October 1996
Justice	3 October 1996	11 October 1996	31 October 1996
Natural Resources and Environment	10 October 1996	10 October 1996	31 October 1996
Premier and Cabinet	8 October 1996	8 October 1996	29 October 1996
State Development	27 September 1996	27 September 1996	31 October 1996
Treasury and Finance	15 October 1996	16 October 1996	31 October 1996

4.2.13 In respect of public bodies, there has been a general improvement in the timeliness of reporting, although approximately one third of the audited financial statements of those agencies were finalised outside the requisite 12 week period.

4.2.14 **The Department of Treasury and Finance needs to investigate the reasons for the delays in the completion of the financial reporting process and take action to ensure that statutory deadlines are complied with by both departments and public bodies. This is particularly important given the impending full implementation of whole-of-government reporting.**

□ **RESPONSE** provided by Secretary, Department of Treasury and Finance

The necessary regulatory change to address the anomaly in the Financial Management Regulations 1994 is to be forwarded to the Governor-in-Council prior to 30 June 1997.

As part of the process of planning for preparation of the Annual Consolidated Financial Statements for the State of Victoria, a reporting timetable has been developed, with the urgency for timely reporting being stressed to reporting entities. It should be noted that in April 1996, a major restructure of administrative arrangements was implemented that affected all departments. This had a significant impact on financial reporting which led to delays. However, it is pleasing to note that the ultimate deadline, for tabling reports in Parliament, was met by all departments.

Part 4.3

State Government Corporate Card

KEY FINDINGS

- At the time of the introduction of the Corporate Card, the Department of Treasury and Finance did not develop a targeted level of cost savings to be achieved nor has it since sought to establish the actual level of savings achieved within the Victorian public sector to ensure that optimum outcomes have been obtained from the utilisation of the Card.
Paras 4.3.7 to 4.3.11
- An audit analysis indicated that the Corporate Card was not widely used, when compared with the level of purchasing activity undertaken within the public sector. Consequently, available cost savings were not being fully realised.
Paras 4.3.12 to 4.3.13
- The absence of central monitoring of Corporate Card utilisation adversely impacts on the ability of the Department of Treasury and Finance, as the responsible central agency, to measure and evaluate the success of the implementation of the Card across the whole-of-government, and formulate strategies to promote its use and maximise any available savings.
Paras 4.3.14 to 4.3.17
- Almost 1 000 Corporate Cards had not been cancelled for up to 12 months after respective public sector agencies had been sold or abolished, unnecessarily exposing the State to financial risks.
Paras 4.3.18 to 4.3.19
- There is a need at the Departments of Justice, and Premier and Cabinet to strengthen the authorisation and verification procedures to ensure the probity and accountability of all Corporate Card payments.
Paras 4.3.24 to 4.3.39
- Audit identified several instances where Corporate Card transactions had not been independently approved, cardholders had not confirmed the receipt of related goods and services and transactions were not supported by adequate supporting documentation. Consequently it was difficult to determine whether such expenditure was incurred for official purposes.
Paras 4.3.32 to 4.3.36

STATE GOVERNMENT CORPORATE CARD

4.3.1 In October 1988, the former Government approved the use of the State Government Corporate Card for the purchase of low value goods and services by public sector departments and agencies. The overall objective of introducing the Card was to enhance the operational efficiency of the accounts payable function within the public sector and, in turn, achieve cost savings as a result of streamlined administrative procedures associated with its use.

4.3.2 While purchases of goods and services with the Corporate Card were initially set at a maximum limit of \$1 000 per transaction, this limit was increased to the value of \$10 000 per transaction in 1994, subject to certain specific conditions being met.

4.3.3 The Corporate Card is used by various departments, statutory authorities, local government bodies, water bodies and hospitals. At February 1997, in excess of 100 organisations held around 4 400 Corporate Cards which had a maximum monthly credit limit of \$22.7 million.

4.3.4 The Department of Treasury and Finance and its related statutory body, the Victorian Government Purchasing Board, have policy responsibility for public sector purchasing. These agencies jointly:

- administer the public sector-wide contracts with Corporate Card vendors;
- promulgate supply management policies and guidelines, including those relating to the use and operation of the Corporate Card;
- authorise the devolution of authority to other government agencies for the management of purchasing activities; and
- monitor and report on agency compliance with government policy.

4.3.5 As a purchasing tool, the Corporate Card poses a number of additional risks and provides certain benefits not applicable to other methods of purchasing goods and services. In particular, the convenience and ease of use of the Card represents both a key benefit and a substantial change in the nature of risks to be managed by public sector entities in their purchasing activities. Corporate Cards, therefore, require a different control framework to manage risks associated with fraud and waste than applies to other purchasing methods.

4.3.6 Other key potential benefits that flow from the use of the Corporate Card include administrative savings arising from reductions in paperwork and streamlining of purchasing procedures. However, the Card also brings with it additional costs for users, including:

- fees charged by Card issuers;
- interest charges payable on cash advances;
- shorter account settlement periods in certain circumstances; and
- additional reconciliation procedures.

Non-achievement of expected cost savings

4.3.7 The introduction in 1988 of the Corporate Card throughout the Victorian public sector was supported by the results of an analysis by the Commonwealth Government in 1987 which concluded that using such cards instead of cheques would result in savings of around \$25 per transaction. The Department of Treasury and Finance did not prepare any estimates or analysis of the possible costs or savings within the Victorian context. However, a subsequent audit of the Australian Government Card by the Australian National Audit Office, in 1993, found that many of the benefits claimed to arise from the use of the Commonwealth Government Card when it was introduced did not eventuate. In particular, it was found that:

- there was no substantial reduction in paperwork;
- cash management advantages were not realised; and
- expected cost savings were offset by the time consuming process of reconciling statements to supporting documentation.

4.3.8 However, the procedures promulgated for the Victorian Corporate Card differ from those which applied to the Commonwealth Government Card. Nevertheless, the validity of relying upon Commonwealth estimates of cost savings for the introduction of the Victorian Corporate Card is questioned.

4.3.9 At the time of the introduction of the Corporate Card, the Department of Treasury and Finance did not develop a targeted level of cost savings to be achieved nor has it since sought to establish the actual level of savings achieved within the Victorian public sector to ensure that optimum outcomes have been obtained from the utilisation of the Card.

4.3.10 The level of actual cost savings and other benefits achieved from the use of the Corporate Card is dependent on:

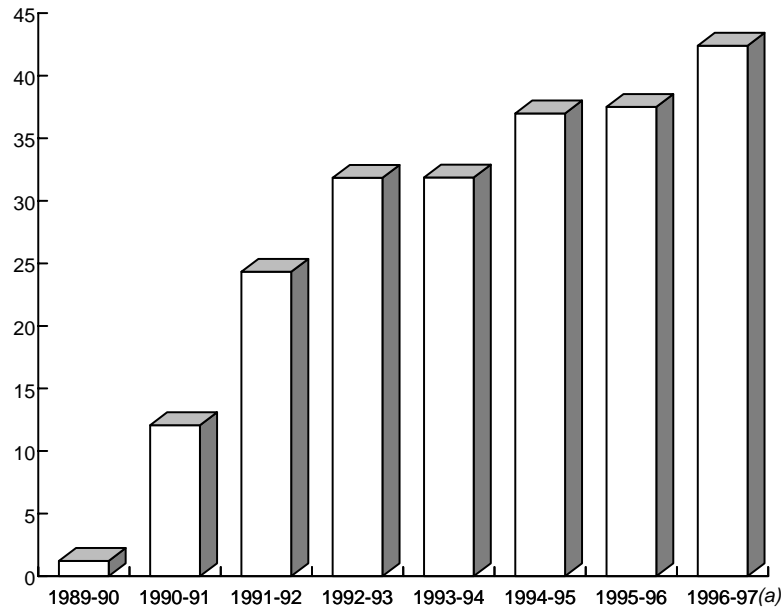
- the extent to which the Card is used;
- the internal control framework adopted to minimise risks; and
- the circumstances under which the Card is used, that is where it represents the most cost-effective purchasing mechanism.

4.3.11 The current policies and guidelines promulgated by the Department of Treasury and Finance do not recommend that agencies conduct their own analysis to identify those transaction types which provide the greatest cost savings from the use of the Corporate Card, and do not provide assistance to agencies in identifying particular circumstances in which the Corporate Card would represent the most cost-effective purchasing tool. That is, the policies and guidelines are predominantly structured around transaction values, rather than transaction types that are appropriate for Corporate Card use.

Utilisation of the Corporate Card

4.3.12 The level of expenditure incurred through the use of the Corporate Card in the public sector has steadily increased since its introduction, as illustrated in Chart 4.3A.

CHART 4.3A
CORPORATE CARD EXPENDITURE, 1989-90 TO 1996-97
(\$million)



(a) Represents audit estimate based on expenditure incurred to February 1997.

4.3.13 However, audit analysis indicated that the Card was not widely used, when compared with the level of purchasing activity undertaken within the public sector. Consequently, available cost savings were not being fully realised. Specifically, audit found that:

- in excess of 60 per cent of cardholder's had made minimal or no use of their Cards during 1996 at the 2 agencies subject to detailed audit review;
- the average expenditure per Card amounted to only \$5 700 during the 1995-96 financial year; and
- only 11 of the State's 1 664 schools had obtained Corporate Cards.



4.3.14 The Government’s 1994 Corporate Card Guidelines require that an annual review of low usage or dormant cardholders be undertaken by the Department of Treasury and Finance in conjunction with the Card issuer. However, audit found that such an analysis, which would identify areas of low acceptance of the Corporate Card and could be used to target promotional activities, had not been undertaken in recent years. In addition, it was found that while the Department does receive quarterly reports from the Card issuer concerning the utilisation of the Cards, there was no evidence of any regular monitoring and review of these reports.

4.3.15 **The absence of central monitoring of Corporate Card utilisation adversely impacts on the ability of the Department of Treasury and Finance, as the responsible central agency, to measure and evaluate the success of the implementation of the Card across the whole-of-government, and formulate strategies to promote its use and maximise any available savings.**

4.3.16 In discussions with representatives of the Department, audit was advised that it did not view its role as extending to monitoring the use of the Corporate Card or monitoring compliance with government policies and guidelines, with this responsibility devolved to the individual agencies. This position is contrary to that expressed by the Parliament’s Public Accounts and Estimates Committee, which stated in its October 1995 *Final Report on the State’s Budget and Financial Management Framework* that:

“The Department of Treasury and Finance has an important responsibility to not only lead accrual based financial management reform but also to monitor compliance with its policies and Ministerial Directions (issued pursuant to the Financial Management Act 1994)”.

4.3.17 Consistent with the above view, **the issue of policy and guidelines by the Department of Treasury and Finance should be supported by a central monitoring role that ensures they are being complied with, and are operating effectively within the respective agencies.**

Untimely cancellation of Cards

4.3.18 Recent public sector reforms have resulted in the sale or abolishment of several public sector agencies. **A review of Corporate Card records, including information provided to audit by the Card issuer, relating to these agencies identified that almost 1 000 cards, with a maximum monthly credit limit of approximately \$4.3 million, had not been cancelled for up to 12 months after the respective agencies ceased to be in public ownership.** While the Department of Treasury and Finance did advise the Card issuer up to 5 months after the privatisation of most of these agencies to cancel these Cards, the Department did not ensure that the Cards were subsequently cancelled.

4.3.19 The terms of the Corporate Card agreement prescribes that the State shall be solely liable for all debts incurred through the use of the Card. **Therefore, the failure to ensure the timely cancellation of Corporate Cards held by agencies that have been sold or abolished, unnecessarily exposes the State to financial risks.** This situation further emphasises the need for ongoing central agency monitoring of the utilisation of the Card.

Inappropriate use of Corporate Cards

4.3.20 The Government Corporate Card Guidelines, issued in 1994, state that Corporate Cards should not be used for cash withdrawals, cash advances and cash equivalent transactions. However, an examination of cardholder reports held by the Department of Treasury and Finance indicated that cash advances, or cash equivalent transactions of \$48 000 had been obtained by various public sector agencies during the 1996-97 financial year, contrary to government guidelines.

Marketing of the Corporate Card

4.3.21 The introduction of the Corporate Card in the 1988-89 financial year was promoted through information sessions aimed at educating agencies on the use and benefits of the Card, which were co-ordinated by the Department of Treasury and Finance.

4.3.22 Since that period, the Department has not maintained a marketing role to promote the benefits of the Corporate Card to agencies and, as previously identified in this Report, has not taken action to address the low level of usage by some agencies.

4.3.23 Marketing strategies, espousing the benefits and resultant cost savings from the use of the Corporate Card, could assist in the achievement of greater acceptance of this method of account payment.

□ **RESPONSE** provided by Secretary, Department of Treasury and Finance

The overall objectives of introducing the Corporate Card in 1989 were much wider than the narrow interpretation provided in the Report and also included:

- *allowing the State's suppliers to receive speedier payment;*
- *reducing the paperwork for both the State and its suppliers.*

In 1994, the transaction limit was reviewed and raised from \$1 000 to \$2 000 for general transactions, and a new limit was introduced of up to \$10 000 for transactions which meet certain specific conditions.

The additional costs associated with the Corporate Card are not material. For example, Corporate Card issuance fees are \$20 per card per annum and interest on cash advances of approximately \$5 800 (see below) is less than \$100 in total.

With regard to the assertion that the Card brings additional costs for users arising from shorter account settlement periods in certain circumstances, the following applies.



□ **RESPONSE** provided by Secretary, Department of Treasury and Finance - continued

The Department of Treasury and Finance's (DTF's) policy for the payment of supplier accounts is 30 days from date of invoice. In the case of the debts incurred through use of the Card, payment typically covers expenditure incurred for the previous period. It is 21 days from the date of the Card issuer's statement when, consistent with the contractual arrangements with the Card issuer, the Card issuer is paid. This therefore typically covers transactions with original suppliers which occurred between 21 and 51 days before payment is made to the Card issuer, an average of 36 days.

The adoption of the Corporate Card was to benefit small business suppliers to government, not the Card issuer. The delivery of this Government's policy of assisting small business by putting in place mechanisms allowing them to receive payment as soon as possible far outweighs the costs intimated in the Report. The resultant operational efficiencies have produced a win/win situation for the Government and for its suppliers.

Non-achievement of expected cost savings

The DTF has provided the facility and general guidelines. Accountable Officers at the departments are responsible for management of the facilities. Directions of the Minister for Finance dictate that it is the responsibility of the Accountable Officer to have proper internal controls and management procedures in place.

Utilisation of the Corporate Card

Audit has not offered any specific criteria to support its assertion that the Corporate Card is not widely used. The DTF is aware that, in New South Wales for the 1995-96 year, total spending incurred by the use of the approximately 3 900 cards issued was \$11.2 million, of which \$6.5 million was cash advances (as per Performance Audit Report, Audit Office of New South Wales, January 1997). The average spend per card in NSW was half that of Victoria.

Nonetheless, it is acknowledged that further savings may be possible.

Central monitoring of the Corporate Card has occurred and has been strengthened within the last 6 months. Monitoring that is currently undertaken covers more than the issues of use and savings targeted by audit.

Untimely cancellation of cards

The DTF's practice is to advise the Card issuer promptly on the need for cancellation of facilities as the occasions demand. These advices, which may be either written or verbal (followed-up by written confirmation), prompt the Card issuer to take steps necessary to minimise any further financial liability to the State.

The DTF notes audit's comments and concerns and undertakes to remind the Card issuer of the need for ongoing, prompt and decisive action relating to cancellation of facilities, bearing in mind the commercial considerations applicable on a case-by-case basis.

□ **RESPONSE** provided by Secretary, Department of Treasury and Finance - continued

Inappropriate use of Corporate Cards

Cash advances, as categorised by the Card issuer, include purchases made at all Australia Post Offices, purchases of overseas bank drafts and some payments to Telstra. The initial guidelines for the use of the Card as published in DMB Circular 89/5 include these transactions among the suggested uses for the Card. All these transactions currently attract interest from the transaction date. Also included in the cash advances category are actual cash withdrawals. This use, which also attracts interest, is contrary to the guidelines.

The DTF investigations have confirmed that actual cash withdrawals have amounted to approximately \$5 800 in the 1996-97 financial year, that is less than 0.01 per cent of total expenditure. Except for one instance, the agencies concerned believe that the transactions have been effected by the most appropriate means available to them, given the circumstances.

The one instance, which was revealed by internal investigations that breached the guidelines, without justification, related to a transaction for less than \$1 000. This card was immediately withdrawn from the cardholder.

To address this issue, the DTF has approached the Card issuer with a view to categorising cash equivalent transactions separately from actual cash withdrawals and seeking repayment/waiver of interest charges on past and future cash equivalent transactions. Given successful completion of these discussions, the Card issuer will be asked to activate recently developed technology which enables the prevention of actual cash withdrawals.

Marketing of the Corporate Card

The DTF does not perceive its role to be that of a marketer of the Corporate Card; this is properly the role of the Card issuer.

Use of Corporate Cards at the Departments of Justice and Premier and Cabinet

4.3.24 A detailed audit review was undertaken of the use of the Corporate Card by 2 public sector agencies, namely the Department of Justice and the Department of Premier and Cabinet.

4.3.25 The Department of Justice is one of the largest users of the Corporate Card, with 300 cardholders who for the 1996 calendar year expended around \$3.6 million through the use of the Cards. On the other hand, the Department of Premier and Cabinet is a medium-level user of the Corporate Card, with 39 cardholders who expended in excess of \$300 000 over the same period. The Cards are used by both Departments for the payment of a wide range of low value goods and services, such as utilities, travel, accommodation and stationery.

4.3.26 Specific comments on the use and control of Corporate Cards within these 2 departments follows.

Policies and Guidelines

4.3.27 The Government's Corporate Card Guidelines require agencies to establish detailed procedures and guidelines for the use and operation of the Corporate Card. In this context, the foreword to the Minister for Finance's Directions under the *Financial Management Act 1994* provides that:

"Procedures and practices must be based on sound internal control principles having regard to the department's exposure to risk. Good internal control procedures not only minimise the possibility of theft, fraud, inefficiency and waste but also serve to protect officers from any unwarranted suspicion in those regards. In addition, internal control procedures provide a means of ensuring compliance with written law and Government and departmental policy.

"Good internal control has the following characteristics:

- (i) proper segregation of functional responsibilities;*
- (ii) a system of authorisation and recording of transactions, including clear management and audit trails, adequate to provide control over assets, liabilities, revenues and expenses;*
- (iii) sound practices to be followed in the performance of duties and functions; and*
- (iv) personnel with capabilities commensurate with responsibilities."*

4.3.28 The Corporate Resources Agency, which provides accounting services to the Departments of Treasury and Finance, and Premier and Cabinet, processes all Corporate Card transactions of the Department of Premier and Cabinet. The Agency has only recently documented procedures relating to the issue and processing of such transactions. However, the procedures issued by the Agency do not comprehensively address all aspects of the use of the Card, such as the conditions of its use, transaction approval processes, restrictions on use, and monitoring and security aspects.

4.3.29 Criteria for determining the eligibility of officers for the receipt and use of Corporate Cards had not been formalised at both Departments. **Furthermore, at the Department of Justice, it was found that:**

- procedures requiring the independent authorisation of changes to cardholder credit limits had not been developed; and**
- 16 terminated employees had not had their Corporate Cards cancelled, until up to 12 months subsequent to the termination of their employment.**

4.3.30 In addition, it was found that at the Departments of Justice and Premier and Cabinet, 179 and 8 cardholders, respectively, did not have the necessary delegations to make purchases, a situation which caused these cardholders to prepare purchase requisitions, therefore reducing the scope for achieving efficiencies from the use of the Cards.

4.3.31 **There is a need for enhancements to current procedures over the issue, use and cancellation of Corporate Cards to ensure appropriate controls over this form of expenditure.**

*Transaction authorisation and audit trail**Department of Justice*

4.3.32 Internal guidelines developed by the Department of Justice require that cardholders sign monthly cardholder activity reports, as evidence of their verification of transactions incurred, and attach the relevant supporting documentation to these activity reports for independent authorisation, and where over \$1 000 for independent certification.

4.3.33 However, audit examination revealed several instances where there was no evidence that transactions recorded on Corporate Card activity reports had been verified by cardholders, or that these transactions had been independently approved.

4.3.34 In addition, the review found that for 9 per cent of the transactions examined, supporting documentation was not available, and in some cases where transactions were supported with documentation it did not adequately describe the goods or services received.

4.3.35 In relation to the payment of Corporate Card accounts, the Card issuer automatically debits the Department's bank account 21 days after the date of each monthly Corporate Card statement, which occurs regardless of whether the Department has verified and approved the expenditure and reconciled the statement. However, audit found that difficulties are experienced by the Department in effectively reconciling these statements.

Department of Premier and Cabinet

4.3.36 Internal procedures at the Department of Premier and Cabinet require cardholders to verify each transaction appearing on their monthly cardholder activity report and attach all supporting documentation for processing, but **do not require transactions to be independently authorised**. However, **audit found that almost all cardholders did not verify transactions appearing on their activity reports as confirmation of the accuracy of the report and the receipt of the related goods and services**. Furthermore, the majority of transactions were not supported by documentation, therefore making it difficult to determine whether such expenditure was incurred for official purposes.

4.3.37 Authorisation and verification procedures need to be strengthened to ensure probity and accountability of all Corporate Card payments.

Current initiatives

4.3.38 The Department of Justice has commenced an internal review of the use of the Corporate Card within the Department. As part of this review, the Department should establish the optimal possible cost savings from the use of the Card and the circumstances under which these benefits could be realised.

4.3.39 Similarly, the Corporate Resources Agency has commenced a review of its accounting services with the aim of redesigning processes to obtain maximum efficiencies in undertaking accounting operations for the Department of Premier and Cabinet and its other client. Audit was informed that as part of this process the use of the Corporate Card will be examined during 1997 and should provide an opportunity for analysing the various purchasing mechanisms available to the Department, including the use of the Corporate Card, to achieve the lowest transaction cost.

□ **RESPONSE** by Acting Secretary, Department of Premier and Cabinet

We note in the body of your Report the comment that a number of cardholders in both Departments made what is considered to be minimal use of their Card during 1996. It is this Department's view that the minimal cost of \$20 per annum per Card make it cost-effective to provide the Card to a number of senior staff who, by virtue of their position, may be required to travel infrequently at short notice or arrange purchases unexpectedly in a variety of situations. We have taken the view that this is a more cost-effective and service delivery-focused method of doing business than the alternative paper-based pre-authorisation and advance of funds or issuing of orders (which assume adequate lead times) or reimbursement of personal expenditure (which assumes adequate personal finances or payment facilities).

Policies and Guidelines

The existing departmental procedures will be reviewed to ensure completeness and reissued to remind all cardholders of their obligations. In addition, the process for determining eligibility for a Card will be documented.

We note your comment about 8 cardholders not having their necessary delegation to make purchases and therefore may not be the most efficient process for purchasing. While there is nothing intrinsically wrong with this situation as long as proper approval to purchase is obtained, and it should be noted that there are still efficiencies to be gained from being able to order instantaneously using the Card, we will review this situation. Until the Business Process Re-engineering exercise in Accounting Services is complete, which may change fundamentally the way we purchase and pay for goods and services, most of these cardholders could be given appropriate delegation.

Transaction authorisation and audit trail

Since September 1996, all activity reports have been sent to the cardholders to insert the appropriate charge code and sign the report, thereby verifying expenditure. We do not believe it is necessary to introduce further layers of approval.

□ **RESPONSE** provided by Secretary, Department of Justice

Policies and guidelines

The Department has recently completed a general "Benchmarking Review" in 1996-97 which also identified Corporate Card usage as an areas for improvement. As a consequence a specific review of Corporate Card management in the Department (including credit limits) and use of Cards in all Business Units will be conducted as a matter of high priority. All Business Unit Managers are also being reminded of the procedures for the issue of Cards, the changing of credit limits and the need to advise early cancellation of Cards for officers who have left the Department.

Also, following the "Benchmarking Review", the Department has sought clarification from the Department of Treasury and Finance as to whether delegation is required for officers who are using the Card as a purchasing method. Payments made by the Card should already have been approved by a delegated officer.

Transaction authorisation and audit trail

As part of the review of Corporate Cards in the Department, performance measures relating to senior managers' obligations will be strengthened to ensure compliance with all financial requirements.

Part 4.4

The Year 2000 Issue - the Millennium Bug

KEY FINDINGS

- A significant issue confronting all organisations maintaining computerised systems is the capacity of date sensitive software and large databases to cope with the changes of dates from the year 1999 to the year 2000.
Paras 4.4.1
- There is currently a lack of appreciation within public sector agencies of the business implications associated with this issue.
Paras 4.4.2 to 4.4.5
- Minimising the associated risks relies on the early review of computerised systems and, where necessary, the establishment of appropriate measures to ensure that such systems continue to correctly function beyond the year 1999.
Paras 4.4.6 to 4.4.7

THE YEAR 2000 ISSUE - THE MILLENNIUM BUG

4.4.1 A significant issue confronting all organisations maintaining computerised systems is the capacity of date sensitive software and large databases to cope with the changes of dates from the year 1999 to the year 2000.

4.4.2 Specifically, since the beginning of commercial computing, programmers have generally represented the calendar year within software and databases as the last 2 digits of the year rather than the 4 digits. The assumption underlying software and databases constructed in this manner has been that the years following the current year always have higher numbers. However, when the year 2000 arrives, this assumption will be incorrect and software and databases will not function properly.

4.4.3 While this issue relating to the year 2000 will have varying impacts on different systems within organisations, it appears that the potential impact may range from significant disruptions to operational collapses. It is widely acknowledged within the business community that the major risks associated with this issue relating to the year 2000 are:

- prolonged unavailability of business critical systems;
- financial losses due to an inability of systems to correctly process and calculate critical transactions over a sustained period of time;
- legal action from customers and creditors that can have financial consequences; and
- malfunction of both information technology (IT) and non-IT systems leading to incorrect information records and in relation to infrastructure support systems, damage to facilities.

4.4.4 As a result of concerns in relation to this issue, audit wrote to 547 agencies within the Victorian public sector during the latter part of 1996, seeking feedback on the measures introduced or being considered within each agency to address the issue.

4.4.5 **It was disappointing that only 200 of these agencies responded to this request. The poor response rate suggests that the issue may not be widely understood within the public sector and that agencies may not be well positioned to deal with the impending problems.** From the responses received, the following observations are made:

- 59 per cent of respondents had at least a basic understanding of the issue;
- 42 per cent of respondents had identified the operational, financial and legal implications of failing to cope with the issue;
- 40 per cent of respondents had initiated an impact analysis and the development of a plan to address all related issues;
- only 3 per cent of respondents had established a realistic budget and had allocated appropriately skilled resources to resolve associated problems;



- only 2 per cent of respondents had obtained advice from their solicitors regarding associated legal liabilities; and
- 62 per cent of respondents had sought and received written assurances from their software suppliers that their systems will cope with dates beyond the year 1999.

4.4.6 In order to address the issues associated with the year 2000, it is essential that a well-planned and phased approach is adopted. Under such an approach, the following steps should be considered:

- introduction of an awareness program within organisations;
- identification of the relevant issues pertaining to the organisation and the provision of appropriate executive support to resolve the issues;
- assignment of responsibility for the project;
- establishment of a detailed plan incorporating a comprehensive budget covering monetary and physical resources;
- establishment of an implementation program for the conversion or replacement of systems; and
- undertaking a comprehensive testing program of amended systems.

4.4.7 Minimising the risks associated with this issue relies on the early review of computerised systems and, where necessary, the establishment of appropriate measures to ensure that such systems continue to correctly function beyond the year 1999.

□ **RESPONSE** provided by Secretary, Department of State Development

The Government is aware of the issues of processing dates beyond 1999. The following steps were taken under the auspices of the IT&T Policy Committee:

- *the Minister for Multimedia wrote to all Ministers in July 1996 informing them of the issues and implications;*
- *release of a formal Year 2000 policy and implementation guidelines to all departments in July 1996 which also included terms and conditions for future software contracts;*
- *informed all departmental Secretaries in July 1996 of the policy, implications and responsibilities relating to the issue;*
- *conducted a seminar for IT Directors on the Year 2000 issue in July 1996;*
- *established in February 1997 a Year 2000 Special Interest Group for IT Directors to share experiences and plans; and*
- *provided, from time-to-time, departmental IT Directors with copies of local and international material on the subject.*

We agree with the Auditor-General's conclusions and the thrust of the recommendations, however, the window for remedial action is now approaching a point where awareness is not the key issue but the rectification is.

Additionally, the Government IT&T Division in MMV has engaged a consultant to provide an independent second opinion relating to the level of Year 2000 preparedness of 3 major departments. The outcomes of this consultancy may be the basis of further action.

Part 4.5

Information technology security

KEY FINDINGS

- While all agencies reviewed had established security procedures to ensure the integrity, confidentiality and availability of information, scope remained for further improvement in the management of information technology.
Para. 4.5.8
- While the Government's information security policies are equally applicable to both the budget and non-budget sector agencies, these policies were only issued to budget sector agencies. As a consequence, there is an increased risk that non-budget agencies may not implement an effective control structure to secure their information system resources and data.
Paras 4.5.9 to 4.5.12
- Agencies had not adequately assessed or quantified information security risks within their organisations.
Paras 4.5.18 to 4.5.22
- There was a lack of contingency planning at agencies which led to reduced assurance as to their ability to continue to deliver essential services to the public in the event of a disaster.
Paras 4.5.24 to 4.5.25

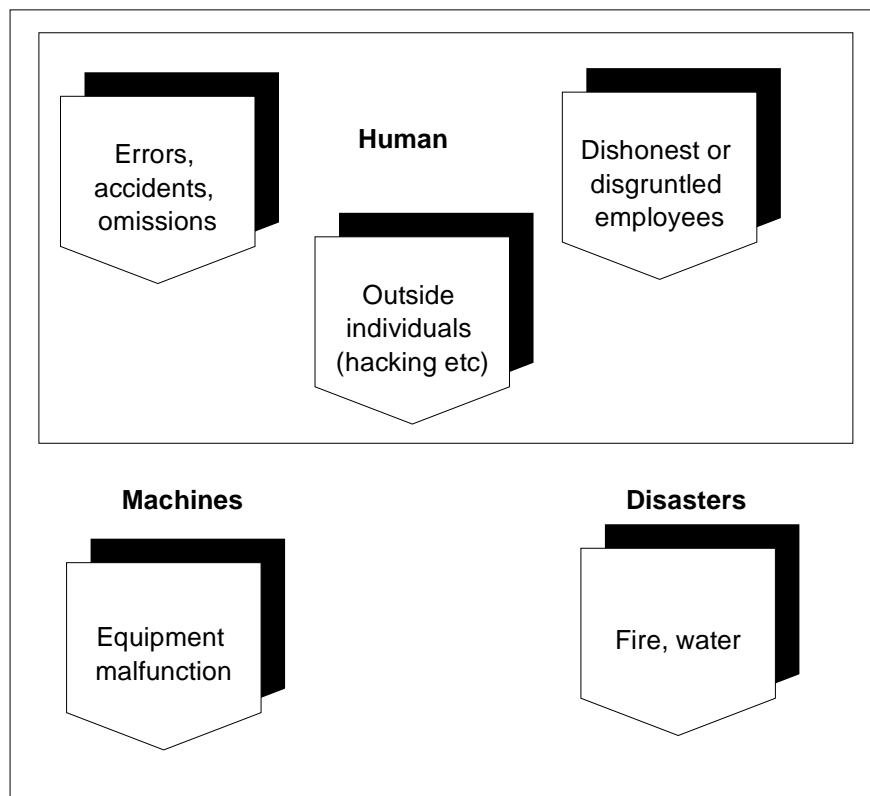
INFORMATION TECHNOLOGY SECURITY

4.5.1 Computer systems support many significant public sector operations, including administrative, financial and operational functions and provide information for decision-making.

4.5.2 While computerisation enhances the accessibility of information, it also increases its vulnerability to unauthorised access and manipulation and as a result information security is a major issue in the management of most public sector agencies. Accordingly, an important responsibility of senior management is the implementation of prudent security measures to protect information in electronic form.

4.5.3 There are a number of risks to information systems, data and resources, as depicted in Chart 4.5A

**CHART 4.5A
MAJOR COMPUTER RISKS**





4.5.4 Information technology (IT) security is a complex and difficult area due to the rapid changes in information technology. The following emerging factors have increased the vulnerability of information and IT systems:

- the move to more inter-connected systems which has provided greater access to extensive databases of information through widely distributed computer network;
- greater reliance placed on electronic records;
- increased computer skills and knowledge of security techniques designed to protect computer systems and electronic information;
- ready availability of equipment and software capable of accessing computer networks;
- difficulties in detecting the copying of information;
- portability of diskettes or cartridges which can hold large volumes of data; and
- non-computer specialists generally unaware of sound security practices.

4.5.5 In addressing these factors, organisations implement IT controls which are designed to reduce the risk of fraud, business interruption, errors, customer dissatisfaction, and the inefficient and ineffective use of resources. In particular, IT controls address the following important objectives:

- integrity of information to support decision-making;
- security and protection of information system assets, including hardware, software and data; and
- compliance with procedures and regulations.

4.5.6 An audit was carried out to evaluate the adequacy of current information security management within the public sector. The audit focused on security practices at 5 selected agencies, 3 from within the budget sector and 2 from the non-budget sector.

OVERALL AUDIT CONCLUSION

4.5.7 Computerised systems have proliferated in the public sector and are now vital in the provision of services to the community. As a result, information security has increasingly become a significant element in the administration of every major activity in the public sector.

4.5.8 While all agencies reviewed had established security procedures to ensure the integrity, confidentiality and availability of information, scope remained for further improvement in the management of information security. The Government has introduced a number of initiatives to improve IT security management but there were a number of issues identified during the review which required attention, including:

- a lack of contingency planning at agencies which led to reduced assurance as to their ability to continue to deliver essential services to the public in the event of a disaster; and
- the agencies had not adequately assessed or quantified information security risks within their organisations.

Government initiatives



4.5.9 In recognition of the importance of IT, the Government has introduced the following initiatives:

- Establishment of the Government Information Technology and Telecommunications Group within Multimedia Victoria. The Group's main focus is on delivering operational guidelines and projects which ensure the co-ordinated and efficient development and deployment of IT and communications resources within government;
- The release by the Group of IT policies and publications which address a wide range of topics and current best practices for use by agencies in the development of their own policies; and
- The establishment of a web site on the internet which communicates the Government's broad IT policies and strategies.

4.5.10 The Government's IT security policy was issued in March 1995 and subsequently re-issued in November 1995. The policy requires agencies to ensure that adequate information security management policies are implemented to protect information assets. More specifically, the policy requires each agency to:

- formulate an information security plan for dealing with risks and potential threats to their information assets in a manner commensurate with business priorities, principles and goals;
- establish security functionality which strikes a balance between ease of use, relative cost and availability of resources;
- follow minimum security measures as set out in the guidelines developed by the Government Information Technology and Telecommunications Group; and
- use the Australian and New Zealand Security Standards on Information Security Management as a guide when implementing information security measures.

4.5.11 It was found that, while the Government's information security policies are equally applicable to both the budget and non-budget sectors, they were only issued to budget sector agencies. Furthermore, procedures had not been established at a central agency level to assess the extent to which agencies had implemented these policies. As a consequence, there is a risk that budget and non-budget sector agencies may not establish an effective control environment to secure their information system resources and data.

4.5.12 To assist in ensuring that valuable public sector information is effectively protected, it is essential that the Government's information security policies be communicated to all public sector agencies

Security awareness, training and education

4.5.13 The audit found that senior management within the agencies reviewed had not undertaken formal training in security awareness and therefore may not have the necessary level of understanding of key security issues that should be considered when managing the risks associated with information technology.

4.5.14 **In order to facilitate the dissemination of the relevant information to all public sector agencies, it is appropriate that the Government Information Technology and Telecommunications Group takes a lead role in the provision of relevant reference and training material and formulates and implements a program to develop the security awareness of senior management.**

4.5.15 In addition to management’s awareness of IT security, an important factor in establishing a secure computer environment is the level of security awareness among employees. It is generally recognised that employees are more likely to conform with security guidelines when they understand the reasons for their establishment.

4.5.16 At the agencies reviewed, it was found that employees, below senior management levels, were provided with varying levels of computer security training, however, in all instances, such training was not periodically updated to ensure the maintenance of appropriate knowledge.

Security planning and risk assessments

4.5.17 The Government’s information security policy requires that, at agency level, security plans “... *should be formulated for dealing with risks and potential threats to their information assets in a manner commensurate with business priorities and goals. Security functionality should generally strike a balance between ease of use, relative cost, feasibility and availability of resources*”. Further, the policy establishes the following minimum steps to be included in developing security programs:

- assignment of responsibility for security;
- establishment of minimum security requirements;
- assessment of risks;
- provision of staff training; and
- development of business continuity planning.

4.5.18 Audit found that 3 of the 5 agencies reviewed had developed a security policy while the other 2 agencies had made substantial progress in the development of a policy. However, a review of the policies at the 3 agencies revealed that:

- senior management at only one agency formally approved and endorsed the policy;
- the policies were not distributed to all staff at any of the agencies;
- following the development of the policies, none of the agencies had developed an implementation plan or reviewed their existing procedures to ensure that they complied with the security policies; and
- specific responsibility for implementation of the policy had only been assigned at one agency.



4.5.19 Agencies need to assess their commitment to the implementation of sound security requirements. In particular, there is a need to establish priorities for the review of IT security policies, the monitoring of risks to information assets, the review of security breaches and the development of major initiatives to enhance information security.

4.5.20 Senior management need to clearly understand the impact on the delivery of services should integrity, confidentiality or availability of computer systems be compromised. Risk analysis is an essential element of an effective approach to information systems security and generally involves gaining an understanding of:

- information assets to be protected;
- possible threats to these assets;
- level of security that is appropriate; and
- action required to secure information assets.

4.5.21 It is widely acknowledged that computer systems cannot be made completely secure. However, risks should be managed and reduced to an acceptable level using security measures commensurate with the value of information and the nature of the risk. Additional security measures may not be justified where costs exceed the value of the information assets to be protected.

4.5.22 Audit found that in relation to the agencies reviewed, one of the agencies had completed information risk assessments. **Accordingly, it was not possible for all agencies to ascertain whether current security procedures and practices are either cost-effective or adequate.**

Contingency planning

4.5.23 Effective business contingency planning ensures that critical business functions are able to continue to operate in the event of a loss of IT facilities. As the majority of critical information is now processed and held within computer systems, it would generally be very difficult for agencies to revert to manual processes to enable the continuation of services in the event of a disaster. Accordingly, the preparation of sound plans for recovery from a disaster is a fundamental management requirement which generally entails agencies to obtain an understanding of current vulnerability, i.e. threats and risks, and the steps needed to be taken to protect the systems to ensure the delivery of services in the event of a disaster.

4.5.24 The audit review indicated that agencies had not made an adequate commitment to contingency planning. In particular, it was found that:

- Only one of the 5 agencies examined had formally assessed the value and sensitivity of their current information and the impact on the organisation should the availability of information be compromised;
- While one of the other agencies had previously developed an understanding of the impact of the unavailability of information on its operations, the assessment was undertaken over 7 years ago and therefore did not reflect the current information requirements;
- All agencies had made arrangements to back up their data and software off-site;



- All but one of the agencies had implemented physical and environmental controls to minimise the risk of loss of all computer sites;
- None of the agencies reviewed had documented and tested contingency plans covering all critical systems, including alternative processing procedures to be followed by user departments during the period that computer facilities were unavailable; and
- Two of the agencies had outsourced their IT services, with the service provider contractually obligated to develop a disaster recovery plan. However, a "mock" disaster recovery test has been successfully completed by only one of the service providers.

4.5.25 The lack of contingency planning at certain agencies exposes the State to the risk that essential services may not be provided in the event of a disaster. Accordingly, agencies need to identify critical computer systems and the associated threats and exposures for use as the basis of recovery planning.

□ RESPONSE provided by Secretary, Department of State Development

The Government agrees with the Auditor-General that information security is an increasingly important issue that needs to be adequately and comprehensively addressed by departmental Secretaries and business managers.

The Government will consider an information security training program for senior executives across government. This will be referred to the IT&T Policy Committee for consideration and action.

It is also agreed that non-budget agencies can benefit from the best practice policies issued by the Government Information Technology and Telecommunications Group. All IT&T policies are publicly available via the internet and will continue to be made available. Departments will also be reminded that they should further distribute relevant policies and guidelines to all non-budget sector agencies within their Minister's portfolio.

The Government does not agree that the Government Information Technology and Telecommunications Group has a specific role in monitoring the compliance of the information security policy. It is the role of departmental Secretaries, their IT Directors and Internal Audit Committees to ensure that the public's information assets are adequately protected and secured. This is consistent with the provisions of the Victorian Managed Insurance Authority Act 1996 which requires Secretaries to have proper risk management processes in place for all assets.

Part 5



Audit Act 1994 Review



Part 5.1

Submission by the Auditor-General of Victoria



CONTENTS

EXECUTIVE SUMMARY	316
1 Objectives of the legislation.....	321
2 Nature of the restriction on competition.....	325
3 Likely effect of the restriction on competition and the economy in general	329
4 Assessing the benefits and costs of the restriction.....	333
5 Consideration of alternative arrangements.....	345
6 Elaboration on the Auditor-General's audit resourcing strategies.....	361
Appendices	
A Conclusions of previous reviews of Auditors-General within Australia	369
B Auditor-General Reports on the Government's Statement of Financial Operations	381
C Ministerial Portfolio Reports to the Parliament.....	389
D Special performance audit reports to the Parliament.....	401
E Current work program of Victorian Auditor-General's Office - Outcomes to be reported to the Parliament.....	425
F Previous independent performance audits of the Victorian Auditor-General's Office - Key conclusions	427
G Victorian public sector agencies - Audit responsibilities at 30 June 1996.....	439
Bibliography	447

EXECUTIVE SUMMARY

On the basis of the information presented in this submission, it is clear that the one identified restriction on competition within the Audit Act - the appointment by the Parliament of the Auditor-General as its exclusive external auditor - should be exempt from reform.

There can be no case for any action which focuses on the convenience of the Executive Government and public sector managers and dilutes the value of the distinctive strengths of the existing independence and total discretion of the Auditor-General in providing external audit services to the Parliament and community. The current arrangements provide the only means of meeting Parliament's objective set out in the legislation and have been independently confirmed as cost effective.

It is recognised that the National Competition Policy focuses on improving the performance of the Australian economy, in part, through the fostering of competition. However, there is a real risk in applying this policy to an area such as the Victorian Auditor-General's Office where the benefits to the community from a restriction on competition are extensive and the cost savings arising from removal of the restriction would, if any, be negligible.

Objective of the legislation

The *Audit Act* 1994 has one objective which is to provide for the office of Auditor-General and the audit of public accounts. This objective establishes the Auditor-General as the sole independent external auditor of the Government and accordingly of all Victorian public sector agencies, on behalf of the Parliament and the community.

The objective of the Victorian legislation is consistent with that governing Auditors-General under the Westminster system of democratic government. Since 1983, at least 15 reviews within Australia commissioned by various Parliaments and Governments have strongly endorsed the exclusivity of Auditors-General as the external auditors of Government and their key role in the public accountability process which involves:

- providing a single independent voice on behalf of the Parliament and the community;
- having a clear mandate to audit and investigate wherever and in whatever way deemed necessary in the public interest;
- having audit responsibility extending across the whole spectrum of government activity; and
- operating free from government influence or control.

The Victorian Parliament has specifically recognised the longstanding absolute independence and discretion assigned by it to the Auditor-General by matching the legislative objective with a direct line of accountability back to the Parliament through the commissioning of annual financial audits and triennial performance audits of the Victorian Auditor-General's Office.

Nature of the restriction on competition

The exclusivity of the Auditor-General as the Parliament's and community's external auditor of the Government, as set out in section 1 of the Act, is the sole legislative restriction on competition. It establishes a barrier to entry by another service provider for the provision of all external audit services of the Government in Victoria.

The appointment by the Parliament of the Auditor-General as external auditor of the Government and its "subsidiaries", which consist of numerous public sector agencies, equates with the appointment by the shareholders of an external auditor of a public company and its subsidiaries.

Once appointed by shareholders, external auditors must have total discretion in decision making on all matters (including the audit scope and approach, and resourcing strategies) when implementing statutory audit functions. Such discretion constitutes a principle which is fundamental to the preservation of the independence and credibility of external auditors. In other words, the absolute independence of auditors and total discretion in the discharge of statutory audit functions cannot be mutually exclusive. The statutory audit functions of the Auditor-General are set out in sections 8, 16 and 20 of the Audit Act which cover financial and performance audits, and the examination of grants to funded agencies respectively.

Likely effect of the restriction on competition and the economy in general

Even when utilising the latest figures published by the Australian Bureau of Statistics which relate to 1992-93, the cost of operating the Office in 1995-96 after deducting payments to private sector audit contractors (who currently assist in 75 per cent of all financial audits) was a mere 0.3 per cent of the national market for the provision of audit and other related services (\$11.8 million as against in excess of \$4 billion). As such, it could hardly be said that the restriction constitutes a substantial lessening of competition or has any more than a minuscule impact on the economy in general.

The insignificance of the impact on competition of the legislative restriction is further illustrated by the fact that fees for audit and other services paid to a private sector accounting firm by just one major public company (The News Corporation Limited) almost equate to the cost of operating the Office excluding payments to private sector audit contractors.

Assessing the benefits and costs of the restriction

While conceptually it may be argued that situations involving restrictions in market competition could adversely impact on the quality and cost of service delivery, in the case of the provision of external audit services of Government in Victoria, the current legislative framework provides the only effective means of producing significant benefits to the Parliament and the community. These significant public benefits, which have been delivered over many years by the Victorian Auditor-General's Office, include consistency in financial reporting and accountability across all public sector agencies, and the breadth and fairness of public interest issues reported by the Auditor-General to the Parliament.

The extensive nature of the public benefits delivered by the Office provides conclusive evidence of the distinctive competence of its multi-disciplinary in-house resources in public sector auditing and reporting which represent a key asset of the Parliament and community. The generation of these benefits also confirms the soundness of the Office's resourcing strategies involving a mix of in-house financial and performance audit resources and external contractors engaged through competitive tendering arrangements.

In sharp contrast with the magnitude of public benefits which arise as a direct result of the restriction, the costs to the community of the restriction would, if any, be absolutely negligible.

The rationale advanced by proponents of greater competition within markets is principally based on the concept that competitive pressures will drive improved quality in service delivery and lower the cost of service provision. However, in the Victorian public sector external audit context, it needs to be recognised that these risks are substantially mitigated through a range of legislative requirements and management strategies. The legislative requirements include independent triennial performance audits of the Office commissioned by the Parliament. The most recent performance audit in September 1995 found that the Office compared favourably with the "Big 6" chartered accounting firms in respect of financial audits, and with equivalent overseas audit offices in regard to performance audits.

Consideration of alternative arrangements

This submission assesses 6 alternative means of providing public sector external audit services including non-legislative means. As part of an ongoing process of extensive continuous improvement implemented by the Office, the various alternative arrangements have been considered and rejected in the past as deficient in that they would:

- impede the independence of the Auditor-General through removal of total discretion in the discharge of statutory audit functions;
- fragment the external audit function and diminish the benefits that flow from having a single independent external audit and reporting voice to the Parliament;
- weaken the accountability of the Government and its agencies to the Parliament; and
- reduce the emphasis given to issues of public interest.

None of the alternative arrangements would achieve the same level of effectiveness especially in terms of public benefits as that produced by the Office under the existing legislative framework. In this framework, Parliament has assigned total independence and complete discretion in the discharge of audit functions including resourcing strategies to the Auditor-General. If any one of the alternative arrangements could have delivered a greater level of effectiveness, it would already have been embraced by the Office in pursuit of its objective of achieving world best practice.

The New Zealand, Northern Territory and Victorian Auditors-General have introduced, as part of their discretionary powers, varying approaches to contestability in their resourcing strategies. The extent of the benefit which accrues to the Parliament and community from the strategies implemented in Victoria, as evidenced from the breadth of public reporting by the Auditor-General, clearly illustrates the effectiveness of the resourcing strategies adopted for financial and performance auditing in Victoria.

Objectives of the legislation

OBJECTIVES OF THE LEGISLATION

The *Audit Act* 1994 has one objective which is set out in section 1 of the legislation in the following terms:

"The purpose of this Act is to provide for the office of Auditor-General and the audit of public accounts".

This legislative objective is to establish the Auditor-General as the sole external auditor, on behalf of the Parliament and in turn the community, of the Government and accordingly of all Victorian public sector agencies as defined in section 3 of the legislation - (Refer Appendix G).

In establishing the Auditor-General as its sole external auditor, Parliament assigned a key role to the Auditor-General in the State's public accountability process. It also reinforced the special relationship of the Auditor-General with the Parliament through the following provisions within the legislation:

- a specific requirement that the Auditor-General can only be removed from office with a resolution of both Houses of Parliament; and
- a direct reporting relationship with the Parliament through the Speaker and the President, in contrast with the position of most statutory officers who report to the Parliament through their Minister.

Simply put, a direct objective of the Parliament is to have its own exclusive external auditor of the Government.

The objective of the Victorian legislation is consistent with that governing Auditors-General under the Westminster system of democratic government. In this regard, the assignment of an exclusive audit role to the Auditor-General is based on the following 3 principles underpinning the public accountability process:

- The Government of the day has an obligation to account to the public for its use of public funds in that it must ensure that funds are raised properly, protected from loss and used only for the purposes approved by Parliament, and that value is obtained for money spent;
- Members of Parliament have the responsibility to scrutinise the affairs of Government. To assist in that scrutiny, the Government must supply Parliamentarians with complete and understandable information on how it has carried out its activities; and
- There must be a knowledgeable and impartial person (the Auditor-General) providing a single voice to the Parliament, with a mandate to examine the information supplied to Members of Parliament by the Government, to make independent examinations of government departments and agencies, and to report significant matters to Parliament, so that the Members can fulfil their responsibility - rooted in history, tradition and law - of holding the Government accountable for its actions.

The legislative objective underpinning the role of an Auditor-General in the public accountability process has been extensively examined by at least 15 reviews within Australia commissioned by various Parliaments and Governments over the last 13 years (refer Appendix A). Major conclusions from these reviews have included:

- The Auditor-General should be appointed by Parliament as its sole external auditor, having responsibility for both financial and performance audits of all Government-controlled entities and reporting as a single voice to the Parliament;
- The independence of the Auditor-General should be safeguarded by precluding Executive Government and its agencies from inhibiting or influencing the performance of his or her functions;
- The Auditor-General should have complete discretion in the conduct of audits and should not be subject to direction in relation to:
 - whether or not an audit is conducted;
 - the manner in which the audit is to be conducted; and
 - the priority to be accorded to any particular matter;
- While the Auditor-General may, at his or her discretion, utilise private sector resources to assist in the conduct of audits, he or she should ensure that their utilisation is not at the expense of a strong Audit Office. In particular, the Auditor-General should ensure that the Office maintains expertise to enable the effective discharge of the key statutory and constitutional responsibilities of the Auditor-General; and
- The links between the Auditor-General and the Parliament are unique and far stronger than any possible links that could develop between the Parliament and numerous private auditors under short-term contract to various government agencies. The convenience of managers of government entities should not be elevated above the convenience of their owners (namely, the Parliament and taxpayers).

Some of the abovementioned reviews referred to in Appendix A (e.g. Commonwealth-1996, Western Australia-1992 and Queensland-1991) followed periods of great concerns in those jurisdictions on the adequacy of public accountability arrangements. In addition, reviews in Victoria-1992 and New South Wales-1990 were established, inter alia, in response to emerging debates on the appropriateness of an Auditor-General having a monopoly responsibility for auditing the public sector.

All 15 external reviews strongly endorsed the exclusivity of the Auditor-General as the Parliament's and the community's sole external auditor with total discretion in undertaking the specified functions to achieve the established statutory objective. These reviews have concluded that such exclusivity and discretion are essential to the achievement of the objective of providing a single independent external audit voice reporting on the totality of Government operations to the Parliament and the public.

The Victorian Parliament has specifically recognised the long-standing absolute independence and discretion assigned by it to the Auditor-General by matching the legislative objective with a direct line of accountability back to the Parliament through the commissioning of annual financial audits and triennial performance audits of the Auditor-General.

Nature of the restriction on competition

NATURE OF THE RESTRICTION ON COMPETITION

The *Audit Act* 1994, under section 1, continues the legislative practice which has been in place in Victoria since the turn of the century of having a statutory office of Auditor-General with sole responsibility for performing, on behalf of Parliament and the community, the role of external auditor of Government.

Because Parliament has determined that the statutory position of Auditor-General shall be the sole external auditor of Government, there is a restriction on competition which effectively establishes a barrier to entry by another service provider for the provision of all external audit services of Government in Victoria, as a single audit and reporting voice on behalf of Parliament.

The above barrier is the only restriction on competition within the provisions of the *Audit Act* 1994.

However, it is important to recognise that the appointment of the person to occupy the statutory position of Auditor-General is subject to competition through a public advertisement process. Under the legislation, future incumbents to the position will initially hold office for a 7 year term.

The Auditor-General, like any auditor in the private sector, must **once appointed** have total discretion on all matters (including the audit scope and approach, and resourcing strategies) when implementing the statutory functions specified for the audit. Such discretion constitutes a principle which is fundamental to the preservation of the independence and credibility of external auditors. This principle applies equally to both private and public sector external auditors and is embodied in professional pronouncements by the accounting bodies within Australia and throughout the world.

The appointment by the Parliament of the Auditor-General as external auditor of the Government and its "subsidiaries", which consist of numerous public sector agencies, equates with the appointment by the shareholders of an external auditor of a public company and its subsidiaries. **It would be ludicrous to suggest that the external auditor of a public company, after appointment by the shareholders, be directed to apply contestability principles to the resourcing of statutory audit functions.**

It is emphasised that the absolute independence of external auditors and total discretion in the discharge of audit functions cannot be mutually exclusive.

Three sections of the *Audit Act*, namely sections 8, 16 and 20, which are presented below, outline the **statutory audit functions** of the Auditor-General, as determined by the Parliament, to achieve the legislative objective as set out in section 1.

Section 8 (1)

"The financial statements of each authority must from time to time and at least once in each year be audited by the Auditor-General or a person authorised by the Auditor-General." (The Auditor-General may dispense with all or any part of an audit of the financial statements of an authority in any year under the provisions of section 8(2) of the Act.)

Section 16 (1)

"... the Auditor-General may conduct any audit he or she considers necessary to determine whether an authority is achieving its objectives effectively and doing so economically and efficiently and in compliance with all relevant Acts."

Section 20 (2)

"The Auditor-General, or a person authorised by the Auditor-General, may, by notice in writing given to a funded agency, require the agency to produce for examination, in accordance with the notice, any documents in relation to a financial year in respect of which the agency has received a public grant."

Examples of specified statutory audit functions for appointed private sector auditors can be found in the Corporations Law and in Statutory Rules relating to Solicitors' and Estate Agents' trust accounts.

Similarly, the external financial auditor and the performance auditor of the Victorian Auditor-General's Office, appointed by the Parliament on the recommendation of the Public Accounts and Estimates Committee, are required to carry out the statutory functions specified for the respective audits under the *Audit Act* 1994.

Notwithstanding the specification in the Act of statutory audit functions for the Auditor-General as the Parliament's external auditor, the Government and its agencies are not precluded from engaging private sector resources to provide financial and performance audit services as part of their management activities.

While some may argue that section 8(1) of the Act which requires that the Auditor-General must undertake financial audits of individual agencies represents a competitive restriction, the section constitutes a compulsory statutory audit function assigned to the Auditor-General, as external auditor of Government, similar to that assigned to a private sector external auditor under the authority of the Corporations Law. Sections 16 and 20 of the Act involve additional statutory audit functions over which the Auditor-General has total discretion in the conduct of audits under these sections.

It is very clear that the exclusivity of the Auditor-General as the Parliament's and community's external auditor of the Government, as set out in section 1 of the Act, is the sole legislative restriction on competition.

It is also relevant to point out that the Auditor-General is not permitted to compete for the provision of private sector external audit services or provide other services to the Government (covering an unlimited range of consultancy services such as policy formulation, outsourcing, information technology, systems implementation etc. and internal audit services, within agencies including primary and secondary schools for the Department of Education) which are available to private sector firms. These constraints, which ensure that the Auditor-General is always free of any conflicts of interest, reinforce the legislative objective of appointing the Auditor-General solely as Parliament's external auditor.

While the sole restriction on competition within the Act involves a barrier to entry by the private sector, in reality, the resourcing strategies determined by the Auditor-General provide for substantial private sector participation to assist in the delivery of public sector external audit services. In fact, around 75 per cent of all public sector financial audits currently within the Auditor-General's mandate are undertaken with assistance from 34 private sector accounting firms, engaged following a competitive tendering process.

Likely effect of the restriction on competition and the economy in general

LIKELY EFFECT OF THE RESTRICTION ON COMPETITION AND THE ECONOMY IN GENERAL

As stated in Part 2 of this submission, the exclusivity of the Auditor-General as the Parliament's and the community's external auditor is the sole legislative restriction on competition. In addition, Part 1 identified that this restriction is essential for the effective achievement of the legislative objective because it provides for a single independent external audit voice reporting to the Parliament on issues extending across the entire range of Government activities, involving numerous public sector agencies.

Without a single independent audit voice, fragmentation of the external audit process would occur and the Parliament and Victorian taxpayers would not be the recipients of the breadth, quality and consistency of auditing and reporting, and the resulting extensive community benefits that have been provided by the Auditor-General and the Auditor-General's Office. Elaboration of this issue is provided in Part 4 which analyses the benefits and costs of the restriction on competition and in Part 5 dealing with alternative approaches.

In considering the impact on competition of the restriction, it is necessary to identify the relevant market.

The *Trade Practices Act 1974*, (section 4E) defines a market as:

"... a market in Australia and, when used in relation to any goods and services, includes a market for those goods and services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods and services".

Under the *Competition Policy Reform (Victoria) Act 1995*, the Competition Code text became a law of the State. The text consists of the Schedule version of Part IV of the *Trade Practices Act 1974* together with most of the remaining sections of the Act, including section 4E dealing with the definition of a market.

Expert advice provided to the Office indicated that some economists will wrongly take the narrow view and argue that the relevant market should be restricted to Victoria. However, as the Auditor-General provides external audit services for the Parliament and private sector accounting firms provide across Australia such services to the shareholders of companies, the nature of the market, having regard to the statutory definition, could be regarded as the provision of audit services nationally. Furthermore, given that the private sector accounting firms also provide other related services which could be substituted for or are competitive with audit services, it is more appropriate to regard the nature of the market as encompassing both audit and these related services Australia-wide.

In this context, the national market for the provision of audit and other related services is estimated to be in excess of \$4 billion, based on the latest information published by the Australian Bureau of Statistics which relates to the 1992-93 financial year¹. The cost of operating the Victorian Auditor-General's Office in the 1995-96 financial year, after deducting payments of \$5.8 million to private sector audit contractors, was \$11.8 million, or around 0.3 per cent of the 1992-93 national market. It can be seen that even when utilising the 1992-93 national figures, it could hardly be said that the legislative restriction constitutes a substantial lessening of competition or has any more than a minuscule impact on the economy in general.

The insignificance of the impact on competition of the legislative restriction is further illustrated by the fact that fees for audit and other services paid to a private accounting firm by just one major public company (The News Corporation Limited²) almost equate to the cost of operating the Office excluding payments to private sector audit contractors.

It also needs to be recognised that as the Auditor-General is excluded from providing audit services other than to the Victorian Parliament, it cannot be argued that the Auditor-General is adversely influencing the market by competing unfairly with the private sector for non-government business.

In relation to the competition effects, consideration needs to be given to not just the granting of exclusive responsibility for Victorian public sector audits, but also that the Auditor-General outsources a substantial amount of this work. In outsourcing, the Office takes advantage of its significant buying power to ensure cost-effective service provision. In effect, the legislative restriction is used to enhance competition among private sector firms, rather than reduce competition.

In addition, the economy wide impacts of the restriction will depend on a range of factors in addition to any competition effects. An important, but difficult to quantify factor, is the enhanced business and community confidence which comes from the knowledge that public sector entities are subject to effective and efficient auditing arrangements by a completely independent body. Also relevant in this regard is the enhanced efficiency of public sector auditing which comes with the economies of scale and scope that flow from the restriction of having a single external audit and reporting voice.

In conclusion, the identified restriction, which is necessary to achieve the essential legislative objective, has a negligible effect on competition and the economy in general.

¹Australian Bureau of Statistics, *Legal and Accounting Services, Australia, 1992-93*, (Catalogue No. 8678.0), Table 8.3, p.24.

²*Business Review Weekly*, March 25, 1996, p.71.

Assessing the benefits and costs of the restriction

ASSESSING THE BENEFITS AND COSTS OF THE RESTRICTION

As previously outlined in this submission, the establishment by Parliament of the Auditor-General as its sole external auditor of Government, having absolute independence and total discretion in the conduct of audit functions, is essential for the effective achievement of the legislative objective.

The position in Victoria concerning the exclusivity, independence and discretion of the Auditor-General, operating as a single external audit and reporting voice to the Parliament, equates with the outcome of the recent review of the Australian Auditor-General and the National Audit Office, conducted in October 1996 by the Joint Committee of Public Accounts of the Commonwealth Parliament. Major conclusions from that review included:

- *"The Auditor-General should be appointed as the auditor of all Commonwealth entities; and ... should have a general mandate to initiate the full range of audits in relation to all Commonwealth entities (including performance audits of Government Business Enterprises).*
- *The personal independence of the Auditor-General, the Auditor-General's mandate, the Auditor-General's audit independence and the financial independence of the Office should be supported in legislation.*
- *The Auditor-General should have complete discretion in the discharge of the audit functions ... In particular, the Auditor-General should not be subject to direction in relation to:*
 - *whether or not an audit is conducted;*
 - *the priority to be accorded to any particular matter; and*
 - *the manner in which the audit is to be conducted".*

While conceptually it may be argued that situations involving restrictions in market competition could adversely impact on the quality and cost of service delivery, in the case of the provision of external audit services of Government in Victoria, the current legislative framework provides the only effective means of producing significant benefits to the Parliament and the community which far outweigh the cost of the restriction on competition. These significant public benefits are the quality and consistency of auditing and breadth and fairness of external reporting in the public interest by the Auditor-General and the Victorian Auditor-General's Office. Furthermore, under the framework, any impact of the restriction is minimised through the extensive accountability arrangements which have been established by the Parliament to ensure that the legislative objective is achieved effectively and efficiently.

It is strongly contended that there can be no case for any action which dilutes the value of the distinctive strengths of the existing independence and total discretion of the Auditor-General in the process of public accountability.

Benefits to the Parliament and the community from the restriction

The benefits from the restriction to the Victorian Parliament and community from the Auditor-General operating as a single independent audit and public reporting voice across the total ambit of Government are outlined below:

- **Capacity to draw on a public sector-wide audit knowledge base and see the "big picture" on a Statewide basis; to undertake audits on a consistent basis covering all aspects of resource management within individual agencies and across Government; and to report in the public interest on issues of strategic significance arising from such audits to the Parliament and community.** The value of these benefits is clearly demonstrated by the importance and diversity of issues of public interest which have been communicated by the Auditor-General to the Parliament. Key issues raised in past reports of the Auditor-General and the major financial and resource management outcomes are summarised in the following appendices:
 - Reports on the Government's Annual Statement of Financial Operations (Appendix B);
 - Annual Reports on Ministerial Portfolios (Appendix C); and
 - Special Reports on individual Performance Audits (Appendix D).

The Office's current work program for performance audits and special reviews, the outcomes of which will be included in future reports to the Parliament, is summarised in Appendix E.

Without a single external audit and reporting voice, the Parliament and Victorian taxpayers would not be the recipients of the breadth, quality and consistency of auditing and reporting from the Auditor-General and the Victorian Auditor-General's Office, as demonstrated in these appendices. Eminent politicians have also supported this view. By way of illustration, Ms Jan Wade, now the Honourable the Attorney-General, in the Legislative Assembly on 28 March 1990, stated that:

"It is very much in the interest of all Victorians that the breadth of the reports provided by the Auditor-General is retained".

Also, the importance of non-fragmentation of the single external audit and public reporting voice was reinforced in an April 1983 report of the Victorian Parliament's Economic and Budget Review Committee, which concluded that:

"... an important principle, from Parliament's point of view, [is] that the Auditor-General should be responsible for auditing all Victorian Government bodies ... so that Parliament can deal with one auditing organisation from which it receives an audit review of all Government organisations".

The significant outcomes set out in the aforementioned appendices provide conclusive evidence of the distinctive competence of the Office's in-house resources in public sector auditing and reporting which represent a key asset of the Parliament and community. These outcomes also provide testimony to the soundness of resourcing strategies (involving a mix of in-house and external resources) carefully formulated over time by the Auditor-General which have been confirmed by the Parliament's performance auditors, Messrs Fergus Ryan (1992) and Alan Talbot (1995) - (Refer Appendix F).

In summary, the restriction on competition is an essential pre-requisite to realisation of extensive benefits to the Parliament and community from external reporting by the Auditor-General and the Office.

- **Greater assurance to the Parliament and community** of having one external audit organisation with a single public interest mission rather than commercial organisations influenced by profit motives and a diversity of interests. Notwithstanding the ethical obligations of auditors, given the wide involvement of the major private sector accounting firms across various sectors of the economy, community confidence in the credibility of the external audit function could be diminished if these firms assumed a greater role in the external audit of Government and had direct access to confidential government papers of a commercial nature, including Cabinet papers, and economic and social policy documentation.

The public interest orientation of the Auditor-General was recognised by the Honourable Mark Birrell, MLC, when in April 1990, in opposition, he stated in Parliament:

"As a servant of Parliament he (the Auditor-General) is independent in that he acts on behalf of us all, he acts in the public interest and not on behalf of the government, any Minister or indeed any individual member of the general public".

- **Ensuring consistency in financial reporting and accountability across all public sector agencies**, through sole responsibility for the audit of Government. This benefit has been publicly recognised by the current Government and in particular the Honourables Alan Stockdale, MP, and Roger Hallam, MLC, who, in Parliament in early 1995, when introducing legislation assigning audit responsibility for Local Government to this Office, stated:

"The government expects significant benefits to flow from the Auditor-General assuming responsibility for all council audits. In particular there will be greater consistency in accounting treatments and disclosures across the State which will improve the usefulness of financial information for performance evaluation and monitoring. The new arrangements will make it easier to identify significant issues impacting on all councils which require action. Most importantly, the government and the community will be able to gain a snapshot of the health of local government".

- **Enhanced independence of the public sector external audit function and Parliament and community confidence in its integrity**, given that:

- the statutory office of Auditor-General is perpetual with authority to report to the Parliament without fear or favour and is thus free from influence by the Executive Government or agencies subject to audit;
- there is freedom from potential or actual conflicts of interest as the Office mandate provides solely for the provision of public sector external auditing services on behalf of the Parliament and the public; and
- the scope, timing and prioritisation of audit activity are not able to be influenced by the Executive Government or its agencies, as the Auditor-General is given absolute investigatory and reporting freedom. This position is recognised by E L Normanton, in his book entitled *The Accountability and Audit of Governments*, in which he states:

"Since the time of Aristotle it has been accepted principle that state auditors should be free from direction, influence and intimidation by, and income or reward from, the authorities and persons whose affairs they are called upon to audit. In this respect they are in a position fundamentally different from internal and commercial auditors, who are paid by the organisation which they are engaged to examine. These auditors protect the position of their employers by ensuring probity and regularity. But the business of state auditors is the protection of society against the selfishness and inefficiency of individuals and corporate bodies. In a parliamentary democracy, society is for this purpose represented by a legislature, and the whole of the executive assumes the aspect of a corporate body. The state auditor may serve the legislature or he may stand alone; what he absolutely cannot do is to be a servant of the executive".

- **Unique efficiency advantages from economies of scale arising from having sole responsibility for all public sector audits and economies of scope resulting from a capacity to conduct both financial and performance audits across government.** The accumulation of specialised knowledge and external public sector audit skills developed by the Office also contribute to such efficiencies. Fragmentation of the external audit process would dissipate these unique efficiency benefits which flow to the Parliament and taxpayers;
- **Effective and efficient allocation of audit resources**, arising from the Auditor-General's total discretion, in acting as a single audit and reporting voice across the public sector, to determine the most appropriate resourcing strategies. The importance of the Auditor-General having total discretion was reinforced by the New South Wales Parliamentary Public Accounts Committee in July 1990, which concluded that:

"... just as the Auditor-General is given power to conduct audits in such manner as he thinks fit, so too must he have the power to organise his Office in such manner as he or she thinks fit".

The Auditor-General is directly accountable to the Parliament under the legislation for the manner in which this discretionary power for resourcing strategies is exercised. This accountability is manifested through triennial performance audits of the Auditor-General and the Office commissioned by the Parliament. In this regard, Mr Fergus Ryan concluded in his August 1992 performance audit report:

"In general, the practices of the Office in matters of management of resources, professional training and development and use of information technology are sound and are comparable to those employed by private sector audit firms of similar size".

Also, Mr Alan Talbot, in his September 1995 report commented favourably on the Office's resource strategies, and concluded that:

"... the Auditor-General has achieved his objectives effectively and done so economically and efficiently".

In relation to the use of private sector contractors and the containment of associated fees, Mr Talbot further indicated that:

"The Office has sound management procedures and cost control mechanisms and is operating on an efficient basis."

- **Enhanced understanding of public sector issues and developments, and of state-of-the-art public sector audit and reporting strategies**, through continuing and unique strategic alliances with Auditors-General, both international and interstate, and the continuity of audit responsibilities assigned by the Parliament to the Office; and
- **Capacity to ensure a uniform level of quality for all public sector external audit work**, whether undertaken in-house or by private sector contractors on behalf of the Auditor-General, through application by the Auditor-General of quality assurance and continuous improvement policies for such audit work. In a letter to the Auditor-General by the Honourable Alan Stockdale, MP, Treasurer of Victoria, in August 1994, on the importance of the Office's quality assurance function for contracted audits of Government Business Enterprises, he stated:

"Clearly, the Auditor-General would overview the work ... to ensure that the State's interests are protected and there is proper accountability to the Parliament".

Costs and risks associated with the restriction, including major mitigating factors

As indicated in Part 2 of this submission, because Parliament has determined that the statutory position of Auditor-General shall be the sole external auditor of Government, there is a restriction on competition which effectively establishes a barrier to entry by another service provider for the provision of all external audit services of Government in Victoria, as a single external audit and reporting voice on behalf of Parliament.

The above barrier is the only restriction on competition within the legislation. Accordingly, any costs arising directly as a result of this restriction could only be identified from determining whether there is any differential between the costs of the current arrangement and those which would be incurred if the position of a single external audit and reporting voice on behalf of Parliament was open to competition. In such a competitive environment, the additional costs incurred by the Parliament and ultimately the community in the setting up and administration of a new tendering process would need to be taken into account. In addition, the conditions of tender, in order to equate with the current arrangement, would need to prohibit other service providers from the provision of services, other than the external audit of Government and its agencies (such as consultancy services).

It is not possible to categorically state that a differential does in fact exist. However, in analysing the Office's cost-effectiveness, some reliance can be placed on the Office's experience since the early 1980s of engaging private sector accounting firms as contractors to assist in carrying out financial audits to meet resourcing needs, a practice accompanied by the benchmarking of audits undertaken using in-house resources against those utilising contractors. Drawing on this experience, it would be very difficult to conclude that there would be any actual cost savings from the removal of the current restriction.

The above situation regarding the insignificance of costs under the current arrangement contrasts sharply with the magnitude of the previously described public benefits, which arise directly as a result of the restriction and are essential to the maintenance of proper accountability to the Parliament over Government operations.

The rationale advanced by proponents of greater competition within markets are principally based on the concept that competitive pressures will drive improved quality in service delivery and lower the cost of service provision. Some of the specific risks espoused by those proponents include inappropriate and inefficient resourcing of responsibilities, untimely service delivery, non-competitive fees and the utilisation of poor or out-of-date methodologies.

However, in the Victorian public sector external audit context, it needs to be recognised that these risks are substantially mitigated through the range of legislative and other factors outlined below:

- **Legislative requirement for triennial performance audits and annual financial audits of the operations of the Victorian Auditor-General's Office to provide an independent assessment to the Parliament** as to whether the Office is achieving its objectives in the most effective, efficient and economic manner. The independent performance audits comprise comprehensive and objective examinations of the key elements of Office operations, including audit resourcing strategies, audit methodologies and the quality of service delivery to ensure that the Office provides optimal value for money from the management of its resources to the Parliament and the community. The level of accountability of the Auditor-General is considered to be greater than that of any public sector entity subject to audit by the Auditor-General. Similarly, there is a greater level of disclosure by the Auditor-General of matters which private sector accounting firms would regard as *commercial-in-confidence*.

The past 2 independent performance audits of the total operations of the Auditor-General and the Office, undertaken in 1992 and 1995 by Messrs. Fergus Ryan of Arthur Andersen and Alan Talbot of Price Waterhouse, respectively, have concluded that:

- The Auditor-General is meeting his objectives effectively, economically and efficiently. The directions and momentum of the Office are positive and constructive;
- The Auditor-General is an integral part of the accountability process by which Parliament ensures that the activities of the Executive are consistent with Parliament's directions;
- The practices of the Office in matters of management of resources, professional training and development and use of information technology are sound and are comparable with those employed by private sector audit firms of similar size;
- The Office's performance audit methodology is advanced in development by world standards and its application to specific engagements is generally of a high standard;
- The Office's financial audit methodology is consistent with current audit thinking and complies with Australian auditing standards;
- The Office is conducting performance audits effectively and efficiently. The quality of performance audits is good especially taking into account the limited resources available;
- The quality of the Auditor General's opinions on financial statements is of a high standard; and
- The Office is currently implementing a computer-based financial audit workpaper system, which is leading edge technology.

It is particularly re-assuring that Mr Talbot, in September 1995, found that the Office compared favourably with the "Big 6" chartered accounting firms in respect of financial audits, and equivalent overseas audit offices in regard to performance audits. These independent findings provide confirmation of the professionalism and competence of the staff of the Office.

In addition, as an Office initiative undertaken subsequent to Mr Talbot's audit, a comprehensive assessment of the Office's recently revised performance audit methodology was carried out by a partner of Price Waterhouse, Canada, in December 1996, who concluded that:

"... the methodology was quite comprehensive and incorporated much of the state-of-art with respect to best practices ... The methodology was an excellent guide book for the conduct of performance audits".

- **Regular consultation and scrutiny by the Parliament's Public Accounts and Estimates Committee (PAEC) of the operations and reports of the Auditor-General and the Victorian Auditor-General's Office.** This process, which is an integral part of the Parliamentary accountability process, involves scrutiny of issues raised by the Auditor-General in reports to Parliament, input into the Office's annual performance audit program and assessment of the issues raised in external performance audit reports on the Office. In the PAEC's 1993 assessment of Fergus Ryan's performance audit report on the Office, the Committee concluded, inter alia:

- *"It is considered appropriate that the Auditor-General retains responsibility for the financial and performance audits of all government business enterprises ... Legislation should require that the Auditor-General audits all entities in which the State has a controlling interest.*
- *There is a greater need for accountability in the public sector than in the private sector ... Where audits of public sector entities are undertaken by private sector firms [as was the case with the State Bank of Victoria], rather than by the Auditor-General, there is a reduction in public accountability.*
- *In conducting performance audits of central agencies, the Auditor-General should utilise external consultants and experts, where he believes this to be appropriate, in order to supplement and complement the existing skill base within the Audit Office ... Should the Auditor-General elect to utilise consultants, he is to retain ultimate responsibility for the overall conduct of the audits.*
- *[Any] proposition that auditees should be able to select their own auditors ... needs to recognise that managers in the public sector owe a duty of accountability to the public (through the Parliament) and that the Auditor-General is an integral part of the accountability framework".*

- **Wide scrutiny during parliamentary debates and by the public of Office reports to the Parliament and a legislative requirement to include agency responses within such reports**, jointly ensure the unassailability of issues raised in reports. The value placed by Members of Parliament on Office reports is clearly reflected in the following comments made in Parliament in October 1991 by the Honourable Roger Hallam, MLC:

"The report has obviously been prepared by a professional, competent, and more importantly, independent officer of Parliament. As members of this House, we can take some heart in the fact that at least we can rely on the accuracy of the Auditor-General's report.

"I pay tribute to the Auditor-General, Mr Ches Baragwanath, and his staff on the report itself but, more importantly, on the clear evidence that he is not intimidated by the government's reaction to his work over the years ... On those grounds alone the Auditor-General's report is absolutely extraordinary".

More recently, in May 1996 following the tabling of my *Report on Ministerial Portfolios*, the Honourable Roger Hallam MLC (Minister for Finance) made the following comment in relation to that Report:

"I am a fierce supporter of the Auditor-General. I am happy for the opposition to quote verbatim page after page of his report because on balance I suggest it is the best report he has produced for many years".

- **Benchmarking of audits** undertaken utilising in-house resources against audits undertaken with assistance from private sector contractors (as mentioned previously and which are engaged following a competitive tendering process), and against audits undertaken by other audit offices across Australia. Use of this yardstick mechanism has shown that the Office's charge-out rates are below both contractors and most other audit offices.
- **Comprehensive annual reporting** by the Office to the Parliament as a major accountability document which enables external scrutiny of performance. This level of accountability contrasts sharply with that provided by private sector accounting firms.
- **Other efficiency drivers**
 - *Periodic meetings between the Auditor-General and Government Ministers* to discuss strategic issues impacting on the audit process and the operations of the Government and their impact on the community.
 - *Surveys of public sector agencies and users of Auditor-General's reports to Parliament* which provide an important and valuable indicator of the quality of reports and service delivery and constitute a key source of input into the Office's continuous improvement strategies. The outcomes of these surveys have been communicated to the Parliament in the Office's annual reports.

- *An external Policy and Practices Advisory Panel*, comprising experts in a range of fields within the private sector and academia, which furnishes advice to the Auditor-General and Office on developments impacting on the public sector.
- *Management strategies* adopted by the Office including maintenance of a corporate culture which emphasises continuous improvement and embraces business planning and performance measurement and reporting, supported by a comprehensive audit management information system, and recruitment strategies which maintain an optimal Office skill mix covering a broad range of professional disciplines.
- *Internal peer review processes* to complement Parliament's external triennial performance audits, which monitor the efficient and effective conduct of audits and promote a continuous improvement culture.
- *Membership and participation by staff in key industry and professional bodies*, including the Australian and international accounting and auditing profession, to ensure that skills are maintained and knowledge updated to enable the efficient and effective discharge of audit responsibilities. An important part of the staff development strategies involves the delivery of a comprehensive training program which also assists staff to attain appropriate professional accreditations.

The above analysis of benefits, costs and risks provides compelling evidence that the benefits of the current restriction are substantial while costs are negligible and risks are comprehensively mitigated by legislative requirements and management strategies. It is clear from this evidence that the current legislative arrangements and resourcing strategies of the Office provide the only effective means of ensuring proper accountability of Government to the Parliament and community.

Consideration of alternative arrangements

CONSIDERATION OF ALTERNATIVE ARRANGEMENTS

Before specifically discussing matters under this heading, it is relevant to point out that the Victorian Commission of Audit, chaired by Professor R R Officer, concluded in its April 1993 report to the Premier of Victoria, the Honourable J G Kennett, MP, that :

"The Commission considered a number of alternative arrangements for external auditing including greater use of the private sector. However, the Commission is of the view that the current system is working effectively".

In addition, the recent review of the Australian Auditor-General and the National Audit Office by the Joint Committee of Public Accounts of the Australian Parliament, chaired by Mr A Somlyay, MP, considered 23 submissions as part of its deliberations, of which only one supported alternative arrangements for external auditing of Government at the national level. It is clear from the Committee's recommendations contained in its October 1996 report to the Australian Parliament, which are aimed at further strengthening the independence and discretionary power of the Auditor-General in the discharge of audit functions and reinforcing the integral role played by the National Audit Office, that it rejected alternative arrangements for external auditing of Government.

Consistent with the continuous improvement philosophy of the Victorian Auditor-General's Office, various alternative arrangements (including recommendations of past reviews conducted by Parliaments and Governments throughout Australia and internationally) for providing external auditing services within the public sector have, over the years, been considered by the Auditor-General to ensure that such services are provided to the Parliament in the most efficient and effective manner, in meeting the underlying objective of the Audit Act.

Past assessments of the various alternative arrangements have been premised on the following essential principles which underpin the legislative objective and the Auditor-General's mandate:

- complete discretion to audit and investigate wherever and in whatever way deemed necessary, in the public interest;
- audit responsibility extending across the whole spectrum of government activity;
- freedom from government influence or control; and
- the Parliament purchasing the totality of external audit services relating to Government solely from the Auditor-General who provides a single independent audit and reporting voice back to the Parliament and taxpayers.

While it is acknowledged that the past assessments were not specifically conducted from the perspective of the National Competition Policy, many of the issues relevant to this Policy were considered.

The most recent comprehensive internal review of service delivery by the Office was undertaken in late 1993, at the direction of the Auditor-General. This review resulted in the restructure of the Office to improve service delivery through an enhanced focus on customer service and the core outputs of the Office, relating to financial and performance audits, while ensuring the effective accountability of the Executive Government and its agencies to the Parliament and the community.

Various alternative arrangements have been considered in the past, some of which have been advanced as reform options in the terms of reference to the Government's competition policy review of the *Audit Act* 1994, and included the following:

- whether agencies should select their own auditor, with the ability to choose between the Auditor-General or private auditors;
- whether agencies should select their own auditor, with the ability to choose between the Auditor-General or private auditors, with such selection subsequently ratified by the Parliament;
- whether the Auditor-General should act as the standard setter for financial and performance audits where agencies have the ability to select their own auditor;
- whether a controlling or central body (other than the Auditor-General) should be established with responsibility for the selection of external auditors of agencies;
- whether the Auditor-General should authorise other persons to undertake some or all financial and performance audits with the Auditor-General responsible as the contracting agent and the authorised persons having responsibility for signing of audit opinions and issuing of audit reports; and
- consideration of alternative means not requiring legislative change.

As part of the ongoing process of extensive continuous improvement implemented by the Office over the years, as reinforced in Part 4 of this submission, the alternative arrangements have been considered and rejected as deficient in that they would:

- **fail to meet the underlying objective of the Audit Act;**
- **impede the independence of the Auditor-General through removal of total discretion in the discharge of statutory audit functions;**
- **fragment the external audit function and diminish the benefits that flow from having a single independent external audit and reporting voice to the Parliament;**
- **result in a weakening of the accountability of the Executive Government and its agencies to the Parliament; and**
- **reduce the emphasis given to issues of public interest.**

None of the alternative arrangements would achieve the same level of effectiveness especially in terms of public benefits as that produced by the Office under the existing legislative framework in which Parliament has assigned total independence and complete discretion in the discharge of audit functions including resourcing strategies to the Auditor-General. If any one of the alternative arrangements could have delivered a greater level of effectiveness, it would already have been embraced by the Office in pursuit of its objective of achieving world best practice.

The key considerations that have led to this conclusion in relation to each of the alternative arrangements for service provision to the Parliament are discussed below.

OPTION 1

Whether agencies should select their own auditor, with the ability to choose between the Auditor- General or private auditors.

This option would depart from the legislative objective set by Parliament of establishing a sole external auditor of Government. Furthermore, the option is directly contrary to a fundamental principle of external auditing that the appointment of an auditor is the sole discretion of shareholders. In the public sector, the Parliament acts as the representative of the shareholders, namely the community, and management comprises Government and its individual agencies.

The functions of the external auditor are to express an independent opinion to shareholders on, and add credibility to, financial statements prepared by management and to independently scrutinise management's performance on behalf of shareholders. As management is the principal subject of independent examination by the external auditor, the distancing of management from the auditor's appointment is paramount in preserving the objectivity and integrity of the external audit function.

The importance of the objectivity and integrity of external audit is reinforced by David Flint, Emeritus Professor of Accountancy, University of Glasgow, in his book *Philosophy and Principles of Auditing - An Introduction* which identifies that one of the basic doctrines of auditing is that the audit "... should be completely objective, unprejudiced by previous involvement in the subject of audit, uncompromised by vested interest in the outcome or its consequences, unbiased and uninfluenced by considerations extraneous to the matter at issue. It is primarily on the basis of its independence that the audit derives its authority and its acceptance ... To secure accountability and reassure the relevant public the audit must be completely independent of those whose conduct is being monitored".

The issues associated with whether agencies should select their own auditor, as was the case with the former State Bank of Victoria, have been extensively examined by a number of reviews within Australia commissioned by various Parliaments and Governments. These reviews have overwhelmingly rejected the option. The following are some relevant conclusions drawn from these reviews:

"[Any] proposition that auditees should be able to select their own auditors ... needs to recognise that managers in the public sector owe a duty of accountability to the public (through the Parliament) and that the Auditor-General is an integral part of the accountability framework."

Victoria - Public Accounts and Estimates Committee -
The Performance Audit of the Auditor-General of Victoria (November 1993)

"... while the results of the Inquiry provide no support for the notion that audit appointments should be 'contestable', that is, open to competition and selection for tender by the auditee, there is a legitimate role in public sector auditing for private audit firms, namely the provision of services on contract to and under the control of the Auditor-General ... private audit firms should be used to complement not supplant the resources of the Auditor-General's Office ... the Audit Office should continue to provide cost-effective, quality services and support to the Auditor-General across all areas of the Auditor-General's wide-ranging audit responsibility ... whatever part private contractors play in public sector auditing, it is clear to the Committee that their involvement must not occur at the expense of maintaining and continuing to develop a strong Audit Office."

New South Wales - Report on the New South Wales Auditor-General's Office - Public Accounts Committee (July 1990)

"Much of the fashion for a move away from audit by the Auditor-General appears to be based on a misunderstanding of the role of an auditor. The purpose of audit is to provide an independent report on management, not service to it. Management freedom should apply to management functions but the appointment of the auditor is the prerogative of owners, not managers ... the owners of Australian Government companies are the people of Australia ... While supporting reasonable devolution of authority to managers, the Committee cannot accept that the de facto choosing of external auditors falls within that range ... the institutional links between the Auditor-General and the Parliament are unique and far stronger than any possible links that could develop between the Parliament and a miscellany of private auditors under short-term contract to various government companies. It is a curiosity of the audit debate so far that the convenience of managers of government entities has received considerably more attention than the convenience of their owners."

Australian Parliament - Government Companies and their Reporting Requirements - Report from the Senate Standing Committee on Finance and Public Administration (November 1989)

A further concern arising from the option of management and agencies having the ability to choose their own auditors is the extensive involvement of the major private sector accounting firms across Government (both centrally on key government policy directions and within individual agencies) through the provision of consultancy services relating to information technology, system design and implementation, policy advice and accounting services, and internal audit services. The appointment by management of private sector firms as auditors who also provide these additional services to the same agencies which may impact on areas subject to audit would cause a major conflict of interest. Such conflict would impact on the external auditor's integrity and objectivity in meeting the needs of the Parliament and taxpayers. To guard against the perception that the provision of such services does not jeopardise audit independence, private sector accounting firms rely on the so called "Chinese walls", the worth of which has been questioned by various commentators.

In a situation where an agency has a right to choose its own auditor, it also automatically raises the issue of a "moral hazard", that is, the temptation of the client agency not to engage an auditor that had in the past given an unfavourable audit report.

In responding to Mr Talbot's performance audit report, the Auditor-General commented on the risk to proper accountability in the public sector of too close an audit relationship with management in the following terms:

"In the report, you have described the Auditor-General's position of having a captive client base as enviable and reinforcing the importance of quality service to client agencies. Clearly, a smooth working relationship between audit and management is important, however, too cosy a relationship can inhibit an auditor from openly communicating views where there are issues which should be publicly disclosed in the interests of proper accountability.

While there is a growing trend to view client services as the objective of all audit activities, this trend runs the risk of failing to recognise the unique responsibilities to the wider community that attach to the audit function in the public sector. I regard the position of having a captive client base as a decided strength especially on those occasions where I may agree to disagree with client agency management. To be able to report publicly in such circumstances, without being unduly concerned about any possible adverse impact on relationships with client agency management, reinforces the independence of an Auditor-General and provides an important safeguard to the primary audit clientele, namely the Parliament and taxpayers of Victoria."

This option should be immediately dismissed as it would challenge the supremacy of the Parliament by elevating the convenience of managers of Government agencies above that of their owners, namely, the Parliament and the community.

OPTION 2

***Whether agencies should select their own auditor,
with the ability to choose between the Auditor-
General or private auditors, with such selection
subsequently ratified by the Parliament.***

Again, this option would depart from the legislative objective set by the Parliament in establishing a sole external auditor covering the totality of Government. Furthermore, freedom to agencies to select their own auditor, with subsequent ratification by the Parliament, would cause fragmentation of the external audit process. This would mean that the Parliament and Victorian taxpayers would not receive the benefits that flow from a single independent external audit and reporting voice in terms of the breadth, quality and consistency of reporting across Government. The value of these benefits, as reflected in the importance and diversity of issues of public interest communicated in past reports of the Auditor-General, is demonstrated in Part 4 of this submission and detailed in Appendices B, C and D.

It is extremely difficult to envisage how fragmentation could actually enhance the effectiveness of the external audit function to the benefit of the shareholders, i.e. the Parliament and the community. As concluded by the Joint Committee of Public Accounts of the Australian Parliament in March 1989:

"One of the advantages of having the Auditor-General between auditees and Parliament is that Parliament can rely on the Auditor-General to identify or to filter the most important audit issues. On the basis of his advice, Parliament may pursue or ignore an issue. The Auditor-General's presence does not stop Parliament from disagreeing with his opinion, but usually his assessment of the importance of audit issues is a starting point for Parliamentary consideration. This function justifies the position of Auditor-General and the maintenance of his or her Office.

In the unlikely event that Parliament were to abolish the Australian Audit Office and allocate audit tasks to private audit firms, very large numbers of individual reports would go to Parliament, which would have the task of identifying the most important issues. Such an arrangement would not exist for very long before another 'filter' with the same functions was put in place to assist Parliament in sorting through audit issues."

The matter concerning the provision by private sector accounting firms of services to management, other than of an external audit nature, which was raised in the earlier discussion on Option 1 would, under this option, also impose on Parliament the somewhat daunting task of ensuring that all ratified auditors were totally free from any conflicts of interest and costs charged for external audit services relate only to such services.

In addition, given that the Parliament commissions an independent triennial performance audit of the Office, it is not clear under both options 1 and 2 what mechanisms Parliament could establish to ensure private sector accounting firms were operating effectively, efficiently and economically. Further, to determine from Parliament's perspective whether payments to such firms produced the most cost effective outcomes would require a level of disclosure by firms of matters such as partner remuneration which, to date, has remained concealed behind a veil of professional privilege.

It is considered that no real gain would be derived by the Parliament or the community, in terms of enhanced public sector accountability and protection of the public interest, from adoption of such an option. Its adoption would be a departure from Parliament's established legislative objective of having a sole external auditor of Government and would significantly lessen the benefits currently flowing to the Parliament and the community from external reporting by the sole auditor.

OPTION 3

Whether the Auditor-General should act as the standard setter for financial and performance audits where agencies have the ability to select their own auditor.

Any option which enables management to select its auditor is totally inappropriate for the reasons already mentioned under Options 1 and 2, i.e. contrary to the legislative objective, inconsistent with basic audit principles and there would be significant weakening of the position of the Parliament and the community from fragmentation of the audit process. It is therefore meaningless to canvass, as part of this option, the assignment of a standard setting role for the Auditor-General.

Even if considered in isolation of this option, the concept of the Auditor-General acting as a standard setter for financial and performance audits is also totally inappropriate as professional auditing standards already exist and rightly are developed by the recognised professional bodies established for this purpose by the two major accounting organisations in Australia. The Auditor-General has a legislative obligation (section 13, *Audit Act 1994*) to comply with these standards.

A further major concern with such a role for the Auditor-General is that it would preclude direct involvement by the Auditor-General and the Office in audits throughout the public sector, and would give rise to the many adverse consequences to the Parliament and the community that would flow from the fragmentation of the audit process, as previously identified in this submission. It would also very quickly dissipate the Parliament's and the community's intellectual capital in the form of the Office's distinctive expertise in public sector auditing and reporting.

The adoption of this option or the separate concept of a standard setting role for the Auditor-General would significantly lessen the effectiveness of the external audit function to the shareholders, i.e. Parliament and the community.

OPTION 4

***Whether a controlling or central body
(other than the Auditor-General) should be
established with responsibility for the selection of
external auditors of agencies.***

It is useful to discuss this option specifically in the context of the history of external auditing of local government in Victoria.

Up to 1992 the former Department of Local Government, as the central controlling body for the sector, had responsibility for the regulation of municipal audits including the appointment of all municipal councils' auditors. Following legislative change, which arose from recommendations of the Municipal Accounting and Audit Practices Review Committee, set up by the then Government, this responsibility was assigned to individual councils. In recommending that councils should appoint their auditors, the Committee referred, inter alia, to criticisms from councils of "*... an apparent lack of consistency in audit work resulting from different approaches from different auditors*". It also stated that it did not support "*... continuation of detailed control and regulation of municipal audit*".

In 1995 the Government initiated legislative amendments under which responsibility for the audit of municipal councils was assigned to the Auditor-General. When introducing the revised legislation to the Parliament, the Honourable Roger Hallam, MLC, the then Minister, indicated that the aim of bringing local government within the purview of the Auditor-General was to:

- ensure greater consistency in accounting treatment and disclosures across the State thereby improving the usefulness of financial information provided by councils;
- make it easier for the Government and ratepayers to identify significant financial issues impacting on all councils; and
- enable the Government and the community to gain a snapshot of the health of local government.

The Government determined as recently as 1995, based on the experiences in the State's municipal councils, that the assignment of audit responsibility to the Auditor-General rather than to a central controlling body or individual agencies is the most effective arrangement.

OPTION 5

Whether the Auditor-General should authorise other persons to undertake some or all financial and performance audits with the Auditor-General responsible as the contracting agent and with the authorised persons having responsibility for signing of audit opinions and issuing of audit reports.

Before discussing this option, it is appropriate to point out that the words "person authorised by the Auditor-General", which appear in several sections of the Audit Act, have a history dating back to the previous century. The words were incorporated in the legislation to enable the Auditor-General to allow a non-qualified or inexperienced officer to be assigned audit responsibilities. This reference has been irrelevant for many years as the Office has, since the 1970s, recruited only qualified personnel.

In a letter dated 31 July 1995 to the Minister for Finance dealing with suggested amendments to the Audit Act, it was again suggested that this outdated reference in the legislation be deleted and that a specific authority to allow the Auditor-General to delegate any power or function be incorporated in the legislation. The Minister was informed that: "... as the Auditor-General is Parliament's only auditor, all audits should be undertaken in his name or under delegation and the Act should not assign his responsibilities to a third person, namely a person authorised by the Auditor-General".

If the Auditor-General assigned his responsibilities to a third person (i.e. other than a staff member employed with the Victorian Auditor-General's Office) for signing of audit opinions and issuing of audit reports, there would be a fragmentation of the external audit function and a diminishing of the benefits that flow from having a single independent external audit and reporting voice to Parliament. The consequence would be an eroding of the effectiveness of the public accountability process.

Where an Auditor-General does not retain responsibility for all audits and thus does not overview the work conducted by private sector firms, based on the Office's past experience with high level reviews of contractors, the Auditor-General would not be in a position to identify significant inconsistencies in financial reporting and accountability across government and ensure that:

- the auditors maintain appropriate quality standards;
- reports to Parliament and agencies address the key financial reporting and management issues;
- issues which arise from individual audits which impact on other government agencies are pursued; and
- significant and common financial management and accountability issues are brought to the attention of Parliament, Ministers, central agencies and individual agencies.

In such circumstances, it would be extremely difficult to envisage how the current level of reporting by the Auditor-General to the Parliament and the consequential

benefits to Parliament and taxpayers could be maintained (the past reporting record of the Office is outlined in Appendices B, C and D).

Use of this option would also be inconsistent with a view expressed by the Honourable Alan Stockdale MP, Treasurer of Victoria, in a letter to the Auditor-General dated August 1994, in which he stated:

"... the Government encourages the contracting out of audits of Government Business Enterprises. Clearly, the Auditor-General would overview the audit and retain the responsibility for the final audit certificate, to ensure that the State's interests are protected and there is proper accountability to the Parliament".

This Government position was more recently confirmed by both the Treasurer and the Minister for Finance when transferring the responsibility for the external audits of local government to the Auditor-General from the private sector. The rationale underpinning the Government's decision to assign total audit responsibility, including the review function, was clearly outlined in comments made in the Parliament by the Treasurer in April 1995 which have been quoted in Part 4 of this submission.

The principles and rationale outlined above have also been reflected in the findings of numerous independent reviews by Parliaments and Governments throughout Australia (refer Appendix A). These reviews have concluded that, while the private sector should be utilised to assist in the conduct of audits within the public sector, the Auditor-General should retain total discretion on the extent of utilisation of these resources and should retain total control of the audits. For example, the Joint Committee of Public Accounts of the Australian Parliament, in March 1989 when considering this issue concluded that:

"A strong Audit Office is essential for maintenance of the accountability of Government organisations and officials to Parliament. The Audit Office must strengthen its capacity to undertake audits. This strengthening would not be achieved if audit office staff merely read reports provided to them by private sector audit firms. Under these circumstances, professional skills would deteriorate and the audit office would become little more than a post box ... Independence would have little meaning unless Audit had the resources to continue to undertake audits of all kinds of government organisations".

More specifically, the 1995 independent performance audit of the Office conducted by Mr Alan Talbot, considered this issue in the context of the Victorian situation. After an assessment of the alternative arrangements, Mr Talbot stated that:

"Some people interviewed have suggested all audit work should eventually be contracted to agents. I consider the present situation to be satisfactory and I do not agree with this suggestion ... In my view it is also important for the Office to retain some practical auditing experience and skill base in order to be able to effectively manage Agents and fulfil its mandate".

It is inappropriate to authorise other persons to undertake some or all financial and performance audits and sign audit opinions and issue audit reports as the resultant fragmentation of the external audit function will diminish the benefits that flow from having a single independent external audit and reporting voice to the Parliament.

OPTION 6

Consideration of alternative means not requiring legislative change

In 2 jurisdictions, namely, the Northern Territory and New Zealand, where the legislative framework in place relating to external audit services to the Parliament directly mirrors that in Victoria, the respective Auditors-General have, in using their discretionary powers, adopted different resourcing strategies to those in Victoria, primarily because of local circumstances.

In the **Northern Territory** private sector firms are contracted-in to assist on all audits. This decision has been made at the discretion of the Auditor-General, rather than through any mandatory legislative requirement, and is principally due to the extenuating local circumstances. These circumstances related to the remoteness of Darwin from the other capital cities and the lack of auditing expertise available at the time of that Office's creation in the early 1980s (the Territory's accounts were previously audited by the National Audit Office). Periodic benchmarking of the provision of external audit services between the Victorian Auditor-General's Office and other audit offices across Australia has indicated that the Northern Territory's resourcing strategy is significantly more costly, i.e. the strategy results in a cost premium to taxpayers. In addition, the Office considers that the breadth and depth of issues reported to Parliament in Victoria clearly illustrate the superior effectiveness of its resourcing strategies, under which in-house expertise has proved to be the most effective means of identifying issues and developing reports to meet the needs of Parliament and the community.

Late in 1992, the **New Zealand Controller and Auditor-General**, in exercising his discretionary powers, established as part of his Office a separate business unit known as Audit New Zealand. This business unit is responsible for the conduct of all financial audits, except those which are undertaken under contract by private sector firms on behalf of the Controller and Auditor-General. Special audits and studies (which includes performance audits) were not assigned to the business unit but continued to be undertaken under the direct control of the Controller and Auditor-General.

At the time the Controller and Auditor-General determined that all financial audits in the Education sector (including 2 670 primary and secondary schools) and a small proportion of his other audit responsibilities would be subject to a competitive tendering process between Audit New Zealand and private sector firms. It was not compulsory for Audit New Zealand to compete for these audits.

By 30 June 1996, other than audits in the Education sector, only 175 audits out of a total of 841 had been subject to contestability, with 79 undertaken by private sector firms. The Controller and Auditor-General in exercising his discretionary powers has determined that the balance of these audits (666 audits, 80 per cent) be undertaken in-house by Audit New Zealand.

As part of the arrangements, the Auditor-General authorised Audit New Zealand and the engaged private sector firms to express the audit opinion on financial statements and issue the audit reports directly to agencies.

Recent discussions with senior officers of the New Zealand Controller and Auditor-General's Office and the Office of the Clerk of the New Zealand House of Representatives indicated that:

- at the time of introduction of the new arrangements, the Office comprised 406 in-house staff and there was limited involvement of the private sector in the provision of external audit services within the public sector other than the Education sector;
- by 1996, after about 3 years, almost 50 per cent of private sector participation has been concentrated with only 2 major private sector accounting firms, which has effectively negated the potential for efficiency gains from the introduction of competition; and
- there has been a significant reduction in the breadth of information reported by the Controller and Auditor-General to the Parliament and the community and mounting concern on this point in the Office of the Clerk of the House of Representatives.

In 1992-93, prior to the full implementation of the contestability arrangements, a total of 10 reports of the Controller and Auditor-General were tabled in the New Zealand Parliament, which equates to the number of reports produced by the Victorian Auditor-General's Office and tabled in the Parliament during 1996. Subsequent to the introduction of contestability, only 2 reports of the New Zealand Controller and Auditor-General were tabled in the Parliament during 1996.

Factors contributing to the significant Victorian output produced to the Parliament include:

- the involvement of in-house staff on financial audits extends beyond the recommendation to the Auditor-General on audit opinions to the identification and examination of issues for subsequent reporting to Parliament, with Parliament regarded as the primary audit client;
- a team of multi-disciplinary and highly skilled staff dedicated to undertaking performance audits;
- the strategic involvement by the Office's staff in key public sector audits;
- the non-fragmentation of the audit process with the Auditor-General retaining responsibility for the expression of all audit opinions and the issue of all audit reports; and
- the Office overseeing work conducted by private sector firms on behalf of the Auditor-General to ensure that the State's interests are protected and there is proper accountability to Parliament.

Unlike the situation in New Zealand, the soundness of the Victorian Auditor-General's resourcing strategies (including the mix of in-house and external resources) is independently evaluated by triennial performance audits on behalf of the Parliament. In this regard, the 1992 and 1995 performance audits have confirmed that the Office is operating in an efficient, effective and economic manner, utilises state-of-the-art audit methodologies, has an appropriate skill and knowledge base, and provides high quality output to the Parliament.

In summary, the Northern Territory, New Zealand and Victorian Auditors-General have introduced, as part of their discretionary powers, varying levels of contestability to their resourcing strategies. The extent of the benefit which

accrues to the Parliament and community from the strategies implemented in Victoria, as evidenced from the breadth of public reporting by the Auditor-General, clearly illustrates the effectiveness of the Victorian approach.

In addition to the above alternative arrangements, it is also appropriate to consider whether private sector auditors appointed to assist the Auditor-General in the audit of agencies should be allowed to provide other services to those agencies.

The Audit Act, which authorises the Auditor-General to conduct the external audit of Government, does not permit the Auditor-General to provide other services such as accounting, taxation advice and consultancies.

Private sector accounting firms are extensively involved in both the private and public sectors in the provision of a wide range of non-audit professional services for their clients. The firms derive a significant portion of their revenue base from such services which include policy formulation, outsourcing, information technology, systems implementation and taxation and accounting advice.

The role and obligations of auditors are dealt with extensively in the professional pronouncements of the major accounting bodies in Australia, which detail the fundamental ethical standards and principles applicable to members of the accounting and auditing profession. These principles include the need for members to be, and to be seen to be, objective, impartial and free of actual, as well as potential, conflicts of interest in the performance of their duties.

The eternal problem of the basic conflict of interest confronts every auditor in the private sector in that while they may desire to be reappointed, the proper functioning of the audit process may well require an aggressive treatment of those who have a major say in the reappointment. In the public sector, this problem is overcome by the legislation which provides the Auditor-General with a continuous audit involvement and imposes significant impediments against dismissal from office. This situation was described by Mr Talbot in his 1995 performance audit report as an *"enviable position"*.

As the legislation does not provide for the involvement of the Auditor-General in the provision of non audit services, it ensures the occupant of the office is always free of any conflicts of interest and reinforces the legislative objective of appointing the Auditor-General solely as Parliament's external auditor of Government.

Likewise, private sector contractors assisting the Auditor-General on audits of public sector agencies must also be free of conflicts of interest and thus have no involvement in the provision of non-audit services to those agencies which may impact on areas subject to audit. To do otherwise would contravene the Audit Act and reduce community confidence in the public sector audit process.

Elaboration on the Auditor-General's audit resourcing strategies

ELABORATION ON THE AUDITOR-GENERAL'S AUDIT RESOURCING STRATEGIES

The Office's financial and performance audit strategies are based on the important principle that the Auditor-General is Parliament's external auditor, providing the single independent audit and reporting voice to the Parliament and taxpayers, and having a mandate to audit and investigate wherever and in whatever way deemed necessary.

FINANCIAL AUDITING

Financial auditing covers the audit (under the authority of the *Financial Management Act 1994*) of the Government's consolidated financial statements and the audit (under the authority of the *Audit Act 1994*) of 547 public sector agencies, which includes examinations of compliance with legislation and government regulation.

Since 1982, the Office has, at its own initiative, discharged its financial audit responsibilities through the use of a combination of in-house staff and private sector resources contracted to assist on audits.

Utilisation of private sector resources

In recent years, in order to meet specific resourcing needs, including reporting responsibilities to the Parliament utilising in-house expertise, the Auditor-General has increased the number of audits which utilise resources from private sector accounting firms. While these firms are engaged following a competitive tendering process, tenders are not submitted by in-house teams.

Currently, 75 per cent of the Office's entire financial client base is serviced by private sector resources (in 1995-96, expenditure on contractors amounted to \$5.8 million). When engaging private sector firms as contractors, the Auditor-General ensures that the independence of the external audit is not called into question because of potential or actual conflicts of interest by precluding the involvement of private sector firms in the provision of non-audit services, a situation which, if allowed, would contravene the spirit of the Audit Act.

As more services are outsourced to the private sector, the Office is finding it increasingly difficult to identify private sector accounting firms to assist in financial audits who are not currently or have not recently provided services to the Government or the agencies subject to audit.

The following tables highlight the level of payments to contractors.

**PAYMENTS FOR CONTRACTED
 AUDITING SERVICES**
 (\$'000)

1993-94	1994-95	1995-96
3 066	3 646	5 849

CONTRACT PAYMENTS, 1995-96
 (\$)

<i>Firm</i>	<i>Amount</i>
Coopers and Lybrand	943 000
Ernst & Young	628 000
Arthur Andersen	537 000
Deloitte Touche Tohmatsu	516 000
Day Neilson	511 000
KPMG	389 000
Bentleys (Vic) Pty Ltd	279 000
Armitage Downie	251 000
Price Waterhouse	250 000
Richmond Sinnott & Delahunty	173 000
Thomsons	133 000
Grant Thornton	128 000
Haines Norton	116 000
Other (a)	995 000
Total	5 849 000

(a) Comprises payments to 21 contractors of less than \$100 000.

As the Auditor-General is responsible to the Parliament for all public sector financial audits, the Office has established, as part of its contract management activities, high level reviews of work conducted by the private sector firms prior to the Auditor-General signing audit opinions and issuing audit reports. Based on past experience, without these high level reviews, the Office would not have been in a position to identify significant inconsistencies in financial reporting and accountability across government and ensure that:

- contractors maintain appropriate quality standards;
- reports address the key financial reporting and management issues;
- issues which arise from individual audits which impact on other government agencies are addressed by the Office; and
- significant and common financial management and accountability issues are brought to attention of Parliament, Ministers, central agencies and individual agencies.

This approach has been supported by the Treasurer of Victoria, the Honourable Alan Stockdale, MP, in a letter to the Auditor-General in August 1994 in which he stated:

"... the Government encourages the contracting out of audits of Government Business Enterprises. Clearly, the Auditor-General would overview the audit and retain the responsibility for the final audit certificate, to ensure that the State's interests are protected and there is proper accountability to the Parliament".

More recently, the Honourable Roger Hallam, MLC, now Minister for Finance, when announcing the legislative changes in the Parliament appointing the Auditor-General as the statutory auditor of all municipal councils effective from 1 July 1995, also advocated an identical role for the Auditor-General in these audits. This Government position was substantially due to the recognition of the value added by the Office through the high level reviews undertaken by the Office on due diligence reports prepared by private sector contractors following council amalgamations.

An independent assessment of the manner in which the Office has managed high level reviews of contracted audits was provided by Mr Talbot in his September 1995 performance audit report. Mr Talbot stated that:

"I am aware of some criticism of this process but I did not find the time taken to fulfil this auditing standards requirement to be excessive".

These high level reviews serve to further reinforce the absolute necessity of a single audit and reporting voice to achievement of complete accountability of Government to the Parliament.

Strategic application of Office in-house resources

To undertake effective reviews of contractors' work, it is important that the Office has appropriate in-house expertise and that the review process adds value and meets the objectives as outlined previously. To maintain expertise and industry knowledge, Office resources are involved in the audit of the agencies responsible for policy formulation and the purchase of services, together with agencies that interface across government and at least one government-owned service provider in each industry segment.

This resourcing strategy was also totally supported by Mr A Talbot (1995), who stated that:

"... I recommend retention of certain strategic audits within each industry to enable the Office to maintain an involvement with the issues facing various industry segments, and to control the agents ... Some people interviewed have suggested all audit work should eventually be contracted to agents. I consider the present situation to be satisfactory and I do not agree with this suggestion".

In addition to audits relating to agencies with policy formulation and the purchase of services (e.g. departments), agencies that interface across government (e.g. Treasury Corporation of Victoria) and selected government-owned service providers, the Office utilises in-house resources to undertake the audit of agencies which have had significant exposures to taxpayers (e.g. Public Transport, State Superannuation and WorkCover).

To ensure the provision of cost-effective audit services (within the previously explained framework), the audits undertaken utilising in-house resources are benchmarked against audits undertaken by private sector contractors and against audits undertaken by other audit offices across Australia.

This resourcing strategy has been assessed by Parliament's performance auditors as the most cost-effective means of the delivery of audit services (Mr F Ryan, Arthur Andersen, in 1992, and Mr A Talbot, Price Waterhouse, in 1995). It is also important to reiterate that these external reviews have concluded that in-house financial audits are conducted using a risk-based leading edge methodology and technology, and compare favourably with those of the Big-6 private accounting firms.

***Importance of financial audit strategy
in effectively reporting to the Parliament***

A fundamental element of the Auditor-General's financial audit responsibilities involves the preparation and presentation of comprehensive reports to the Parliament, which provide a key means for ensuring that the Government is fully accountable for its financial operations and performance to the Parliament and the community.

For the Auditor-General to be in a position to effectively discharge his or her statutory responsibilities and, in particular, to provide the Parliament with sound and comprehensive assessments of strategic financial management issues, it is essential that the Office has a direct and detailed involvement in the audit of key public sector agencies.

The current reports to the Parliament resulting from the financial audit process comprise the annual Report on Ministerial Portfolios and the Report on the Government's annual Statement of Financial Operations. The success of the current financial audit resourcing strategy is reflected in the importance and diversity of the issues of public interest consistently brought to Parliament's attention over many years. Key issues raised in past reports and the major outcomes are summarised in Appendices B and C attached to this submission.

The Report on Ministerial Portfolios provides information to the Parliament on a diverse range of issues which are identified during the financial audit process, while the Report on the Government's Statement of Financial Operations provides a comprehensive analysis and assessment of the Statewide financial results achieved by the Government and related issues.

The identification of issues for inclusion within both reports requires a detailed knowledge of public sector strategies and operations, and arise substantially from strategic financial audits which are undertaken using in-house resources. In the case of the Statement of Financial Operations, the Auditor-General's Report is required by legislation to be prepared within a very tight timeframe.

It is very important to recognise that the information communicated to the Parliament in reports of the Auditor-General on the Government's Statement of Financial Operations and on Ministerial Portfolios is, almost without exception, the product of the Office's in-house competence and expertise in public sector auditing and reporting. The experience of the Office over many years has been that very few public interest issues have been pro-actively identified by private sector contractors when assisting on financial audits.

In other words, without the direct involvement of the Office in the financial audit of key public sector agencies, there would be a substantial reduction in the ability of the Office to identify strategic issues and to report on them to the Parliament.

PERFORMANCE AUDITING

All performance audits are conducted by in-house staff with qualifications and practical experience in a range of areas such as program evaluation, social sciences, economics, science and finance. These staff have unique expertise in external performance auditing and reporting, covering resource management issues within a public sector environment, including audits within individual agencies and extending across a range of agencies. There is no equivalent audit function within the private sector culminating in comprehensive public reporting across all facets of resource management.

The Office's expert performance audit staff have been responsible for the breadth and diversity of key issues and related outcomes communicated in past performance audit reports by the Auditor-General to the Parliament, which have focused on various significant and high risk areas of public sector operations. Appendix D attached to this submission summarises the wide range of outcomes arising from the issues addressed in the 47 special performance audit reports produced by the Auditor-General since the early 1980s.

Subject to consultation with the Public Accounts and Estimates Committee, the Audit Act provides the Auditor-General with total discretion in the selection, timing, scope and resourcing of performance audits by including the provision "*the Auditor-General may conduct any audit he or she considers necessary*". The Office has placed considerable emphasis on the selection and planning of performance audits in order to:

- focus on the accountability of the Government in key areas of public interest;
- minimise the risk of agencies not achieving value-for-money; and
- maximise the use of available Office resources.

The effective selection and planning of performance audits requires the maintenance of a sound knowledge of developments both within individual portfolios and across Government generally. The strategy of maintaining an in-house resource base with active involvement in the conduct of performance audits is seen by the Office as essential to maintaining this whole-of-government knowledge.

The Office's performance audit methodology, which is a risk-based value-added approach, was developed exclusively in-house and is specifically aligned to the Auditor-General's legislative mandate for performance audits. The methodology was favourably commented upon by Mr Fergus Ryan, in his 1992 performance audit report on the Office, who stated that:

"The Office's performance audit methodology is advanced in development by world standards" and, in relation to performance audit reporting, "... the Office is at the leading edge by world standards".

Also, as mentioned in Part 4 of this submission, a partner of Price Waterhouse, Canada, concluded in December 1996, that the methodology, as recently revised by the Office, incorporated much of the state-of-the-art with respect to best practices.

To complement the multi-disciplinary in-house staff, external specialists are engaged to provide specific advice and assistance to the Office to ensure a credible outcome on those audits where skills and knowledge in the subject area are not available and it is not cost-effective for the Office to engage such skills on an ongoing basis. The cost-effective management of specialists participating in performance audits is a prime responsibility of the in-house audit staff.

By way of illustrations, in the performance audit of the Alfred Hospital, the services of a private sector medical practitioner were used to assist in the audit; in relation to the performance audit on the State's Child Protection Services, 2 widely recognised experts in child welfare provided assistance; and in the audit dealing with Marketing Government Services, an expert with in excess of 20 years standing in the fields of advertising and market research was utilised.

In most cases, specialists who assist on performance audits are engaged following a competitive tendering process. The cost of external specialists represents a small component of the Office's outlays on contractors.

The use of external specialists to assist on performance audits will remain an integral part of the Office's performance audit resourcing strategy. The practice of supplementing in-house performance audit resources with external specialists on an as-needed basis is a common practice of Auditors-General within Australia and overseas.

The policy by the Government of outsourcing services will necessitate a greater emphasis on the reporting by agencies of outcomes and outputs. Assessing outcomes and outputs is an area where the Office has gained extensive experience over a number of years in its performance auditing function. The Office holds the view that widespread use of outsourcing by Government enhances the need of the Parliament for an independent performance auditing function experienced in determining whether reported outcomes and outputs have been achieved.

In addition and similar to the position with financial auditing, as more services are outsourced to the private sector it will be increasingly difficult for the Office to identify external specialists, particularly within the major private sector accounting firms, to assist in performance audits who are independent of the Government and the agencies subject to audit.

Finally, in relation to the level of the Office's performance audit resources, Mr Talbot, in his 1995 performance audit report on the Office, stated:

"It is my personal view that progressively increasing the resources by 30 per cent a year is practical and desirable".

Appendix A

Conclusions of previous reviews of Auditors-General within Australia

KEY THEMES

- The Auditor-General should be appointed as the Parliament's sole external auditor, having responsibility for both financial and performance audits of all government-controlled entities and reporting as a single voice to the Parliament.
- The independence of the Auditor-General should be safeguarded by precluding Executive Government and its agencies from inhibiting or influencing the performance of his or her functions.
- The Auditor-General should have complete discretion in the conduct of audits and should not be subject to direction in relation to:
 - whether or not an audit is conducted;
 - the manner in which the audit is to be conducted; and
 - the priority to be accorded to any particular matter.
- While the Auditor-General may, at his or her discretion, utilise private sector resources to assist in the conduct of audits, he or she should ensure that their utilisation is not at the expense of a strong Audit Office. In particular, the Auditor-General should ensure that the Office maintains expertise to enable the effective discharge of the key statutory and constitutional responsibilities of the Auditor-General.
- The links between the Auditor-General and the Parliament are unique and far stronger than any possible links that could develop between the Parliament and numerous private auditors under short-term contract to various government agencies. The convenience of managers of government entities should not be elevated above the convenience of their owners (namely, the Parliament and taxpayers).

EXTRACTS OF CONCLUSIONS

AUSTRALIAN PARLIAMENT Joint Committee of Public Accounts

Guarding the Independence of the Auditor-General Report 346 (October 1996)

After considering a range of submissions, the Joint Committee of Public Accounts chaired by Mr Alex Somlyay MP concluded that:

- The Auditor-General should have complete discretion in the discharge of the audit functions ... In particular, the Auditor-General should not be subject to direction in relation to:
 - whether or not an audit is conducted;
 - the priority to be accorded to any particular matter; and
 - the manner in which the audit is to be conducted.
- The Auditor-General should be appointed as the auditor of all Commonwealth entities; and ... should have a general mandate to initiate the full range of audits in relation to all Commonwealth entities (including performance audits of Government Business Enterprises).
- The Auditor-General should have the ability to engage professional services on contract to assist in the performance of audit functions.
- The personal independence of the Auditor-General, the Auditor-General's mandate, the Auditor-General's audit independence and the financial independence of the Office should be supported in legislation.

WESTERN AUSTRALIA Public Accounts and Expenditure Review Committee

Report on Minimum Independence Requirements for the Auditor-General (October 1996)

The Parliamentary Committee chaired by the Hon. M W Trenorden MLA, after considering the issue of independence for the Auditor-General, concluded that:

- The Auditor-General should be independent ... should be an Officer of the Parliament.
- The Auditor-General should have some flexibility in the nature of audits conducted and by whom.
- Parliament should appropriate resources for the Auditor-General to audit as he thinks fit and take a role in determining the budget of the Office separate of the Executive.

NEW SOUTH WALES Public Accounts Committee

**Review of the Audit Office of NSW under Section 48A
of the Public Finance and Audit Act 1983 (April 1996)**

The Report to the Public Accounts Committee of New South Wales on a review of the NSW Audit Office, by an appointed panel comprising private sector and professional body representatives (supported by research work undertaken by 3 major accounting firms), concluded:

- All possible measures should be taken to strengthen the independence of the Auditor-General from central government.
- In his performance of audits, the Auditor-General should address and report on each of the 3 elements of economy, efficiency and effectiveness, but should be given full professional discretion on how much weight, if any, is to be given to each.

**VICTORIA
Public Accounts and Estimates Committee**

***The Performance Audit of the Auditor-General of
Victoria (November 1993)***

The review by the Victorian Parliament's Public Accounts and Estimates Committee chaired by the Hon. G G Weideman MP, of the Fergus Ryan performance audit of the Office of the Auditor-General, concluded that:

- There is a greater need for accountability in the public sector than in the private sector ... Where audits of public sector entities are undertaken by private sector firms, rather than by the Auditor-General, there is a reduction in public accountability.
- It is considered appropriate that the Auditor-General retains responsibility for the financial and performance audits of all government business enterprises ... Legislation should require that the Auditor-General audits all entities in which the State has a controlling interest.
- In conducting performance audits of central agencies, the Auditor-General should utilise external consultants and experts, where he believes this to be appropriate, in order to supplement and complement the existing skill base within the Audit Office ... Should the Auditor-General elect to utilise consultants, he is to retain ultimate responsibility for the overall conduct of the audits.

- The Committee accepts that it should not be able to direct the Auditor-General to conduct specific [performance] audits as it is recognised that this would compromise the Auditor-General's independence.
- [Any] proposition that auditees should be able to select their own auditors ... needs to recognise that managers in the public sector owe a duty of accountability to the public (through the Parliament) and that the Auditor-General is an integral part of the accountability framework.

VICTORIA
Victorian Commission of Audit

Report of the Victorian Commission of Audit
(May 1993)

After considering a paper produced by a consultant, Mr K Stevenson - Partner of Coopers and Lybrand, the Commission of Audit chaired by Professor Bob Officer concluded that:

- The Auditor-General should determine the most cost-effective means of undertaking audits.
- Independence needs to be protected (as it is) by a special relationship with Parliament, which precludes the Government from inhibiting it in any way.
- Parliament needs to have a single voice providing an opinion to it on the hundreds of public sector reporting entities.
- After considering a number of alternative arrangements for external auditing, including a greater use of the private sector, the Commission was of the view that the current system was working effectively.
- The Auditor-General should be responsible, on behalf of Parliament, for the financial and performance audits of all public sector entities.

WESTERN AUSTRALIA

Report of the Royal Commission into Commercial Activities of Government and Other Matters (November 1992)

The Royal Commission into corruption, illegal and improper conduct within Western Australian Government operations, headed by G A Kennedy, concluded that:

- To secure the effectiveness of the Auditor-General as a vital and independent instrument of accountability, all public sector bodies, programs and activities involving any use of public resources, should be the subject of audit by the Auditor-General.
- The Parliament has a special responsibility to ensure both that the independence and the effective resourcing of the Auditor-General are secured ... the office itself must be safeguarded and enhanced ...
- It is imperative that the Auditor-General be responsible for his or her actions, and that Executive arm of government be denied the practical capacity to impair the full and effective discharge of the responsibilities of the office ... the Auditor-General should be free from undue governmental influence ... it is inappropriate for the executive to have a significant capacity to diminish the Auditor-General's role.
- As important as the independence and integrity of the offices themselves is the reassurance that should be provided to the public that the significant functions they perform are being discharged fully and effectively.

AUSTRALIA

Report of the Independent Auditor - On an Efficiency Audit of the Australian National Audit Office in accordance with the Audit Act 1901 (September 1992)

The Report on the efficiency audit into the Australian National Audit Office, conducted by Michael Sharpe from Coopers & Lybrand, concluded:

- The Australian National Audit Office should have responsibility for the financial audits of all Commonwealth-controlled bodies.

VICTORIA
Public Bodies Review Committee

***Report to the Parliament on the "appropriate model for
corporatisation
of the State Electricity Commission (June 1992)***

The all-party Public Bodies Review Committee, chaired by the Hon. W.A. Landeryou MLC, reported in 1992 as part of its extensive inquiry into corporatised Government Business Enterprises, inter alia, whether such entities should be free to choose private auditing firms rather than the Auditor-General. In its final report, the Committee recommended that the Auditor-General should conduct the financial and performance audits of such bodies.

QUEENSLAND
Electoral and Administrative Review Commission

***Report on Review of Public Sector Auditing in Queensland
(September 1991)***

The Commission inquiry chaired by Mr Tom Sherman, into public sector auditing in Queensland, following the Fitzgerald Royal Commission, concluded that:

- The Auditor-General should be the statutory auditor of all departments, statutory bodies, associated bodies and all local authorities, but in every case should have the discretion to contract out audit work where appropriate.
- The Auditor-General should have the authority ... to undertake performance audits.
- Private firms could possibly be utilised to greater advantage in the more commercial areas of government. At the same time, the Auditor-General would need to ensure that the Office maintains core expertise in all areas of audit activity in order to provide effective monitoring of all audit work and to provide a sufficiently broad and challenging range of work for permanent staff of the Office.

**NEW SOUTH WALES
Public Accounts Committee**

***Report on the New South Wales Auditor-General's
Office (July 1990)***

The Committee's review, chaired by the Hon. Phillip Smiles MP, into the operations of the NSW Audit Office concluded that:

- The Auditor-General must continue to be responsible for the audit of all statutory bodies and departments [including financial and performance auditing].
- The Auditor-General's independence, expertise, concern with the quality and integrity of financial management and audit, direct and public reporting relationship with Parliament and role in distilling the results of hundreds of audits and identifying key issues for the attention of the Executive and Parliament are vital features of the accountability process.
- While the results of the Inquiry provide no support for the notion that audit appointments should be "contestable", that is, open to competition and selection for tender by the auditee, there is a legitimate role in public sector auditing for private audit firms, namely the provision of services on contract to and under the control of the Auditor-General ... private audit firms should be used to complement not supplant the resources of the Auditor-General's Office ... the Audit Office should continue to provide cost-effective, quality services and support to the Auditor-General across all areas of the Auditor-General's wide-ranging audit responsibility ... whatever part private contractors play in public sector auditing, it is clear to the Committee that their involvement must not occur at the expense of maintaining and continuing to develop a strong Audit Office.
- Legislation be introduced to permit the Auditor-General to appoint such staff to the Office and to such levels as he or she considers necessary to assist in discharging the Auditor-General's statutory duties and functions.
- Just as the Auditor-General is given power to conduct audits in such manner as he thinks fit, so too must he have the power to organise his Office in such manner as he or she thinks fit.

AUSTRALIAN PARLIAMENT
Senate Standing Committee on Finance and Public
Administration

Government Companies and their Reporting
Requirements
(November 1989)

The Report by the Senate Committee, which was chaired by Senator John Coates and aimed at improving accountability over public administration, concluded:

- There is widespread official support in jurisdictions comparable with that of the Australian Government for the retention of the Auditor-General as the external auditor of all government agencies. The Committee took evidence in similar vein from representatives of the accounting profession and accounting representatives ... all Commonwealth undertakings, of whatever legal form, should be audited by the Commonwealth Auditor-General.
- A requirement for the audit of Commonwealth undertakings by the Australian Audit Office would not rule out the use of private auditors under contract to the Office. However, the responsibility must remain with the Auditor-General and, accordingly, he or she must be named as auditor and must retain total control of the audit.
- Much of the fashion for a move away from audit by the Auditor-General appears to be based on a misunderstanding of the role of an auditor. The purpose of audit is to provide an independent report on management, not service to it. Management freedom should apply to management functions but the appointment of the auditor is the prerogative of owners, not managers ... the owners of Australian Government companies are the people of Australia ... While supporting reasonable devolution of authority to managers, the Committee cannot accept that the de facto choosing of external auditors falls within that range.
- The institutional links between the Auditor-General and the Parliament are unique and far stronger than any possible links that could develop between the Parliament and a miscellany of private auditors under short-term contract to various government companies. It is a curiosity of the audit debate so far that the convenience of managers of government entities has received considerably more attention than the convenience of their owners.

QUEENSLAND

Report of a Commission of Inquiry pursuant to Orders in Council - Commission of Inquiry into Possible Illegal Activities and Associated Police Misconduct (July 1989)

The Royal Commission headed by G E Fitzgerald which inquired into various allegations of illegal activities and conduct within Queensland, inter alia, concluded that:

- The Auditor-General's reports to Parliament, other than in exceptional circumstances, have been basically formal and contained little by way of critical comment. ... the effectiveness of the Auditor-General's staff was less in relation to senior officials who had greater authority ... self-imposed limitations [on the scope of audit activity and reporting to the Parliament] should be reviewed if the Auditor-General is to become an effective check on the abuse of public money. The Auditor-General's office should also be given resources to the extent necessary for the role to be fulfilled.

AUSTRALIAN PARLIAMENT Joint Committee of Public Accounts

The Auditor-General: Ally of the People and Parliament: Reform of the Australian Audit Office, Report 296 (March 1989)

After considering a wide range of submissions, the Joint Committee of Public Accounts chaired by R E Tickner MP concluded that:

- The Auditor-General should be maintained or restored as the external auditor of all statutory authorities, government business enterprises and government companies ... and should continue to have the authority to engage private sector auditors, where he or she considers appropriate, to audit on his behalf on a contract basis ... One of the advantages of having an Auditor-General between the auditees and Parliament is that Parliament can rely on the Auditor-General to identify or to filter the most important audit issues.
- A strong Audit Office is essential for maintenance of the accountability of government organisations and officials to Parliament. The Audit Office must strengthen its capacity to undertake audits. This strengthening would not be achieved if audit office staff merely read reports provided to them by private sector audit firms. Under these circumstances, professional skills would deteriorate and the audit office would become little more than a post box ... Independence would have little meaning unless audit had the resources to continue to undertake audits of all kinds of government organisations.
- The granting to certain types of public instrumentalities the right to appoint their own auditors had weakened public accountability ... and reduced the flow of financial information on government companies to Ministers and the Parliament.

VICTORIA
Economic and Budget Review Committee

***Accountability Requirements Affecting Subsidiary
Companies of Government Organisations with
Special Reference to V/Line Industries Pty Ltd
(November 1986)***

The review by the all-party Parliamentary Committee, chaired by the Hon. D E Henshaw, recommended that all subsidiaries of government organisations be audited by the Auditor-General.

VICTORIA
Economic and Budget Review Committee

***Improving Government Management and
Accountability - A Report to Parliament on a Review
of the
Audit Act 1958 (April 1983)***

The review of the Victorian Parliament's Economic and Budget Review Committee chaired by B J Rowe MP, which involved wide public and private sector consultation, concluded that:

- As an important principle, from Parliament's point of view, that the Auditor-General should be responsible for auditing all Victorian Government bodies ... so that Parliament can deal with one auditing organisation from which it receives an audit review of all government organisations ... Moreover, the Auditor-General is truly independent of the organisations being audited because of his statutory appointment ... also he does not need to negotiate with the organisation over fees or any other aspect of the audit appointment, all of which can compromise independence.
- The scope of external audit in the Victorian public sector should be expanded to cover efficiency and effectiveness issues as well as traditional financial and compliance audit issues.
- The Auditor-General should be encouraged to use the expertise and resources of private accounting firms as his agents ... but with the Auditor-General accepting ultimate responsibility for the standard of this audit work.
- The Committee supports ... freedom for the Auditor-General to determine his own allocation of total Office funds provided.

Appendix B

Auditor-General Reports on the Government's Statement of Financial Operations

KEY THEMES

The previous Auditor-General Reports on the Government's Statement of Financial Operations (previously known as the Finance Statement) have commented on a wide range of strategic issues, including:

- Escalation in the level of budget deficits (over successive years prior to 1992) and their adverse impact on debt levels and the State's capacity to deliver programs.
- Various expenditure deferral and revenue advancement strategies having a substantial impact on the budget sector's reported financial results.
- Incurrence of expenditure of \$35 million without parliamentary authority and the use of artificial financing arrangements to raise borrowings from the private sector, impacting on the State's compliance with Loan Council requirements.
- Need to enhance financial and resource management in the State through the introduction of accrual accounting for departments, whole-of-government reporting, and improved asset and liability management.
- Substantial exposures to taxpayers arising from various financial collapses, including the State Bank, Tricontinental, Farrow Group of Building Societies and the Victorian Economic Development Corporation (VEDC).
- Scope for substantial efficiencies in relation to the collection of State taxation.
- Exposures, risks and accountability to taxpayers associated with various substantial arrangements involving the provision of public infrastructure by the private sector.
- Financial results achieved by the State from major privatisations and property sales, including the associated obligations and risks retained by taxpayers.
- Identification, for the first time, of the total level of State debt.

MAJOR OUTCOMES

The issues raised in previous Auditor-General Reports to the Parliament have contributed to the effective financial accountability of the Executive to the Parliament, and the following major additional financial and resource management outcomes:

- Enhanced financial and resource management through the introduction of accrual accounting for departments and whole-of-government accounting on an accrual basis.
- Improved budget management, including the discontinuation of budget deficit policies/strategies, expenditure deferral arrangements and the use of borrowings to finance operating costs.
- Improved budget sector asset management through the identification and valuation of assets and the increased focus on improved management practices.
- Enhanced reporting and management of State liabilities, including the obligations associated with budget sector debt, unfunded superannuation and private sector infrastructure arrangements.
- Improved reporting and management of the State's contingent liabilities.
- Enhanced accountability arrangements in relation to privatised public companies (relating to the introduction of final audits to the date of sale).
- Enhanced accountability for public companies, trusts and joint ventures through introduction of a requirement for their audit by the Auditor-General.
- Termination of certain costly infrastructure arrangements involving the private sector (i.e. Accelerated Infrastructure Program, transport leases).
- Establishment of the State Revenue Office, through the amalgamation of the prior 2 taxation offices, aimed at improving State revenue collection and administrative efficiencies.



MAJOR ISSUES RAISED

Report on the Government's Statement of Financial Operations, October 1996

- Comprehensive analysis of major privatisations and property sales, including the benefits derived and the key risks and future obligations retained by the State. The report also disclosed various inducements provided by the State relating to the major sale transactions.
- Specific disclosure of the net benefit to the State of \$4.8 billion from the sale of 6 electricity businesses and analysis of the results achieved from the sales of Port of Geelong and Port of Portland assets, the World Trade Centre and the Northcote bus depot.
- Identification of the increasing reliance of the Consolidated Fund on revenues derived from gambling activities (in the order of \$1.1 billion).
- Identification of increased financing costs of up to \$154 million resulting from income tax rulings provided on structured financing arrangements.
- Disclosure of a cost to the State of around \$291 million from the termination of a transport sale and lease-back arrangement.
- Disclosure of the key risks and obligations of the State arising from the complex private sector infrastructure arrangements established in relation to the New Prisons Project.
- Identification of \$11.7 million operating costs incurred by the State to 30 June 1996 in relation to the Formula One Grand Prix event.

Report on the Government's Statement of Financial Operations, October 1995

- Comment on need for the State to present whole-of-government financial statements to enhance accountability, as such statements had not been prepared since those produced by the Victorian Commission of Audit.
- Identification of substantial improvement in the budget sector operating result in 1994-95.
- Disclosure of the net benefit to the State of \$621 million from the sale of United Energy Ltd.
- Highlighted sale of the Grain Elevators Board at \$74 million less than the book value of the assets sold.
- Disclosure of action commenced by the Government to terminate the costly Accelerated Infrastructure Program.
- Progressive identification of the State's increasing unfunded superannuation liabilities.
- Disclosure of key State exposures and risks relating to the delayed introduction of the transport automated ticketing system.

**Report on the Government's Finance Statement,
October 1994**

- Recommended need for Government to establish a firm timetable for the introduction of accrual accounting in departments.
- Disclosure of the substantially improved operating result for year, after taking into account abnormal items.
- Highlighted non-disclosure of Accelerated Infrastructure Program obligations of \$205 million as a State liability.
- Disclosure of State debt assumption relating to the restructure of the Portland Smelter Unit Trust.
- Disclosure of \$98 million shortfall met by taxpayers from the wind-up of the Victorian Equity Trust.
- Identified poor recording and management of State contingent liabilities.
- Identified lack of financial analysis by Government prior to issue of Grand Prix indemnities.

**Report on the Government's Finance Statement,
October 1993**

- Disclosure of the improved operating result for the year prior to abnormal items.
- Highlighted commencement of action to eliminate prior-year expenditure deferral arrangements.
- Disclosure, for the first time, of estimated liabilities of the State of \$72 billion.
- Reiteration of need for comprehensive reporting of budget sector asset holdings.
- Identification of poor return achieved from the sale of the State Insurance Office.
- Reiteration of need to advance implementation of departmental accrual accounting.

Report on the Government's Finance Statement, October 1992

- Identification of the escalation in the level of the overall Consolidated Fund deficit and its impact on budget sector debt.
- Disclosure of day-to-day operating costs of \$1.2 billion funded from borrowings.
- Identification of various expenditure deferral and revenue advancement strategies used by the Government to manipulate the cash-based reported result by \$1.5 billion.
- Highlighted Consolidated Fund interest payments off-set outside the Fund.
- Identification of the final cost to taxpayers from the failures of State Bank, Tricontinental, Farrow Group of Building Societies, Victorian Economic Development Corporation (VEDC), and Victorian Investment Corporation (VIC) of \$4 billion.
- Assessment of the complex arrangements established to finance the St Vincent's Hospital re-development, which increased State liabilities by around \$140 million.
- Identified deficiencies in recording and management of State contingent liabilities.
- Highlighted substantial increase in impact of finance charges on the State budget.
- Disclosure of impact of earlier denial of audit access to Loan Council correspondence, resulting in inability to determine State compliance.
- Recommended need to apply stringent control measures to lock-in potential benefits from employee departure programs.

Report on the Government's Finance Statement, October 1991

- Identification of the escalation in the level of the overall Consolidated Fund deficit and its impact on budget sector debt.
- Disclosure of various expenditure deferral and revenue advancement strategies, having a \$610 million impact on the reported financial results.
- Identified non-recording of certain finance charges within the Consolidated Fund.
- Identification of a cost to taxpayers in excess of \$3.1 billion from the failure of the State Bank and Tricontinental.
- Disclosure that the State only received \$808 million from the sale of the State Bank from a taxpayers perspective, compared with the \$1.6 billion agreed sale price.
- Highlighted that the financing arrangements relating to the construction of the World Trade Centre increased the State's liabilities by \$149 million.
- Disclosure of the estimated \$657 million aggregate financial obligations of the State from the failure of the Farrow Group of building societies.
- Reiterated need for comprehensive departmental asset information.

- Disclosure of operating expenditure of \$398 million funded from borrowings.
- Identification of scope for substantial efficiencies from amalgamation of State Taxation Office and Stamp Duties Office and improved revenue collection.
- Recommended need to improve accountability of public sector companies, trusts and joint ventures.

Report on the Government's Finance Statement, October 1990

- Identification of escalating deficits over the past decade and their impact on debt levels.
- Identified incurrence of expenditure of \$35 million without parliamentary authority.
- Highlighted substantial expenditure deferral arrangements, impacting on reported financial results.
- Highlighted substantial increase in the cost of short-term financing by the Consolidated Fund.
- Identification of the increasing impact of debt finance charges on the State's capacity to fund programs.
- Highlighted use of artificial arrangements to raise borrowings from the private sector, including the illegal issue of Treasury Bills by the Victorian Development Fund.
- Disclosure of an estimated \$700 million net debt assumption by the State from the State Bank, plus financial obligations relating to Tricontinental.
- Disclosure of an estimated Government commitment of \$250 million in relation to the Farrow Group of Building Societies.

Appendix C

Ministerial Portfolio Reports to the Parliament

SUMMARY OF MAJOR OUTCOMES IDENTIFIED

In terms of public benefit, the special reviews performed by the Victorian Auditor-General's Office and reported to the Parliament via the annual Ministerial Portfolios Reports have provided an independent examination of a wide range of significant financial and resource management issues and activities.

A summary of the major outcomes and issues arising from past special reviews are listed below.

- Restructure of public hospital service provision within the State, including the rationalisation of hospital infrastructure through the development of Health Care Networks.
- Enhanced property management by the State and its major authorities, including the establishment of improved recording and administrative arrangements, more efficient use of government accommodation and the disposal of substantial surplus properties.
- Achievement of estimated annual savings in the order of \$51.5 million from the outsourcing of cleaning services at educational institutions, providing impetus to the wider introduction of outsourcing arrangements throughout the public sector.
- Closure of the Construction Group of the former Department of Planning and Housing, due to inefficient and unproductive work practices.
- Implementation of improved maintenance programs and arrangements in relation to public housing which have contributed to enhanced standards of public housing and financial benefits to the State.
- Greater efficiency and improved productivity achieved through the rationalisation of transport workshops and other maintenance infrastructure and the introduction of improved work practices and arrangements at public transport depots. As at the end of 1992-93, annualised savings of the order of \$44.5 million had been achieved.
- Reduction in the level of unfunded superannuation liabilities of the public sector, and enhanced management of the State's employee superannuation arrangements.

SUMMARY OF MAJOR OUTCOMES IDENTIFIED -
continued

- Enhanced disclosure of the substantial obligations and commitments of the State associated with various major arrangements involving the provision of public infrastructure by the private sector and the privatisation of government business enterprises. These have included the Melbourne City Link and the sale of electricity businesses.
- Substantial improvement in the management of the State's motor vehicle fleet, including the rationalisation of the fleet by 15 per cent and the establishment of management and information systems.
- Outsourcing of the provision of Metropolitan bus services, resulting in substantial savings in the cost of service provision and improved service delivery.
- Reduction in the number of surplus trams and light rail vehicles used in the provision of transport services.
- Disposal of surplus government employee housing.
- Improved administration and management of Occupational Health and Safety through the implementation of more focussed service delivery programs and consolidation of this function within the Victorian WorkCover Authority.
- Implementation of substantial reforms related to the management and administration of WorkCover, which have contributed to the improved performance of the scheme.
- Improved management of port infrastructure, and eventually the divestment of substantial port assets at the Port of Geelong, Portland and Melbourne.
- Enhanced revenue collection at the Sheriff's Office through the development of an integrated computer system and the amalgamation of administrative processes.
- Improved management of outstanding debts of the Solicitor General's Office.
- Introduction of a plan to assist in assessing and improving the effectiveness of the National Campaign Against Drug Abuse.
- Restructure of the Home Opportunity Loans Scheme to enhance its management and performance.
- Improved strategic management of the Melbourne Water sewer infrastructure.

SUMMARY OF MAJOR OUTCOMES IDENTIFIED -
continued

- Sale of the Government Printer, resulting in the elimination of annual deficits associated with its ongoing operation.
- Improved arrangements associated with the management of information system development projects, system security and operations, which have contributed to more effective utilisation of IT resources.
- Restructure of the financing arrangements associated with construction of the National Tennis Centre, contributing to its improved financial performance.
- Revamp of arrangements associated with the delivery of the kindergarten program, including the introduction of more flexible models of service delivery.



MAJOR ISSUES IDENTIFIED

In broad terms, the major issues raised in special reviews relate to:

- the inefficient use of resources;
- disclosure of programs and activities that have proven to be ineffective;
- poor management practices;
- the identification of procedures or arrangements that pose a risk to the State and the public;
- disclosure of the financial arrangements of some of the State's largest infrastructure projects which involve the private sector, including the identification of certain potential conflicts of interest;
- improvements that could be made to save money or generate greater revenues;
- the identification of procedures designed to enhance the delivery of services to the public; and
- the identification of ways in which organisational structures, management frameworks and project management could be strengthened.

A summary of the major issues identified as a result of special reviews in recent years is provided below.

Ministerial Portfolios Report, May 1996

- The State has provided certain indemnities and warranties under the sale arrangements of the electricity bodies which may expose the State to further liability and costs.
- The financial statements of United Energy Ltd did not reflect the reality of its financial position.
- Substantial State obligations and commitments arising from the establishment of arrangements with the private sector for the construction, operation and financing of the Melbourne City Link.
- Uncollected fines at the Sheriff's Office have increased from \$41.3 million in 1986-87 to \$366.6 million in 1994-95.
- Payments of \$70 581 were made to a former senior public servant in excess of contract entitlements.
- The provision of a gift valued at \$9 500 to a senior public servant upon departure was extravagant.
- The expected benefits of between \$16 million and \$24 million from the establishment of Victorian Funds Management Corporation have not been realised.
- Significant savings available to public hospitals by revising Visiting Medical Officer engagement arrangements.
- Scope exists for the rationalisation of services by the ULA with cost savings and effective utilisation of resources.

- University of Melbourne properties under-utilised or inappropriately utilised for lengthy periods.
- Leasing arrangement associated with funding the construction of University of Melbourne's IT & Electrical Engineering building resulted in additional costs of \$5.1 million.
- Assets leased by third parties from Municipal councils for nominal rents were utilised for commercial purposes.
- The strategic plan for the management of the State's leased and owned accommodation in the Melbourne CBD does not incorporate a costed long term preventative maintenance program.
- Significant funding allocations are still required to arrest ongoing deterioration of some Treasury Reserve properties.
- Inefficient utilisation of government accommodation.
- Dead rent amounting to \$12 million for the 18 month period to December 1995 was incurred on vacant accommodation.
- Some agencies did not comply with the annual reporting requirements relating to disclosure of consultancy services.
- Crown casino allowed to increase the number of gaming tables at the new casino from 200 to 350 for an additional fee of \$85 million. The Department of Treasury and Finance estimated the additional profit to Crown Casino from the additional tables was between \$194 million and \$259 million prior to the payment of the additional licence fee.
- A formal business case to outsource the IT functions of the Public Transport Corporation and Vic Roads was not prepared. The PTC paid the outsourcer approximately \$2.2 million for services that were not required.

Ministerial Portfolios Report, May 1995

- GASCOR and Generation Victoria estimate a gross exposure for petroleum rent resource tax of \$1 billion.
- The Gas & Fuel Corporation estimated its maximum exposure for land remediation of 349 contaminated sites at \$244 million.
- The Gas & Fuel Corporation has provided for a \$20 million liability in relation to legal proceedings associated with its repudiation of a lease agreement for new head office accommodation.
- A loss of \$149 million was recognised by the SECV, representing the difference between the purchase price and the recoverable value of its building.
- Gaming machine assets of the TAB have been written down by \$48.5 million over 2 years and appear to have been disposed of well below their true value.
- Melbourne Water Corporation has written off \$17.5 million relating to the development of a computerised customer billing system.
- A large metropolitan public hospital and 2 large country hospitals were not financially viable.
- The real value of financial assistance to recipients of municipal, water and sewerage rate concessions has been substantially eroded.

- Substantial increases in Crimes Compensation Tribunal payments have occurred.
- The high level of outstanding legal fees due to the Solicitor-Generals Office has resulted in insufficient funds to pay for professional assistance provided.
- There has been a significant deterioration in the Solicitors' Guarantee Fund's financial position.
- The Home Opportunity Loan Scheme's operating result continued to deteriorate with its deficit increasing to \$13 million in 1993-94.
- Changes in the mode of service provision in 5 country transport services have resulted in reduced patronage levels.
- Government agencies need to publish both quantitative and qualitative performance indicators to facilitate effective performance measurement and monitoring.
- Further improvement is needed in the development of policies covering the use of computer software.
- Computer software and hardware registers were either non-existent or inadequate.

Ministerial Portfolios Report, May 1994

- Based on construction costs, the sale of Loy Yang B power station by the SECV resulted in a deficiency of \$402 million to the Commission.
- The purchasers of Loy Yang B and the financiers enjoy the benefits of a government guarantee.
- Surplus space and under-utilised facilities exist within public hospital infrastructure.
- Only \$13 000 out of a total of \$6.7 million was applied from the Community Support Fund for research on the social impact of gaming.
- The Occupational Health and Safety Authority's work inspection program was not based on sound risk based planning framework.
- Occupational Health and Safety inspectors spend only 26 per cent of total available days within the workplace.
- Employers may not be fully aware of their responsibilities in respect to health and safety problems.
- Significant changes were implemented in the management strategies of the TAB resulting in abnormal adjustments of \$96 million.
- The State's Rural Water supply infrastructure is aged and substantial levels of expenditure on asset replacement and maintenance will be required.
- Little action taken to address the declining financial viability of the Victorian Institute of Marine Sciences.
- Duplicate and inconsistent personnel and payroll information exist within the Directorate of School Education.
- The Gas & Fuel Corporation may be required to pay compensation for the cancellation of a lease on a building which was specifically constructed for the Corporation.

- Continuing employment of surplus SECV employees are adversely impacting on projected outsourcing benefits
- Uncertainty surrounds the occupancy of a SECV leased property due to declining staff numbers.
- The Department of Treasury and Finance needs to evaluate more cost effective banking services.
- No assessment has been undertaken on the effectiveness of the National Campaign Against Drug Abuse despite expending \$78 million.
- The Department of Health and Community Services has not formulated a long-term strategic capital works plan for the development of hospital infrastructure.
- \$131.7 million is due to the State in uncollected fines.
- 58 per cent of all warrants are returned unexecuted due to unreliable database.
- 11.3 per cent of loans under the Home Opportunity Loan Scheme are in arrears.
- The Department of Transport incurred expenditure of \$229 500 without tender board authority.
- There is still an absence of competitive re-tendering procedures for school bus contracts.
- The absence of clear objectives and the use of loosely framed eligibility criteria were the major reasons for the substantial expansion of the Multi-Purpose Taxi Program's membership numbers and subsidy costs.
- Annual subsidy costs for the multi purpose taxi Program have increased to \$17.2 million.
- The Transport Accident Commission has forgone income of \$5.3 million as a result of its buy back offer to holders of Victorian Government Security Bonds.

Ministerial Portfolios Report, May 1993

- VicFleet was not effectively discharging its role and substantial scope existed for rationalisation of the motor vehicle fleet.
- The estimated costs to the State of not replacing existing vehicles at the optimum interval were around \$13 million.
- Processes established in managing WorkCare claims were not effective.
- An absence of competitive forces and shortcomings in cost-management have necessitated corrective action re: the outsourcing of Melbourne Water IT services.
- Significant sewer collapses resulted in outlays of \$13 million and caused temporary pollution to the Maribyrnong river and bayside beaches.
- Disposal of 122 hectares of Melbourne Water surplus land delayed.
- Asset registers in schools and administrative centres were inadequate.
- Current school dental health services were not provided in the most cost effective manner.
- Improved efficiency in kindergarten services and substantial savings in government subsidies could be achieved through increasing the level of teacher contact hours.
- Estate Agents Board's ability to generate additional income was limited by legislation.
- The introduction of alternate State electoral roll maintenance will generate savings of around \$2.3 million for each 4 year election cycle.
- The non lodgement of bond moneys is costing the Residential Tenancies Fund a minimum of \$750 000 each year in interest.
- Financial benefits forgone due to delays in implementing a preventative maintenance program by the Department of Planning and Development.
- Victoria had the second highest public rental property vacancy rate.
- Losses of almost \$3.3 million were incurred through purchasers defaulting on loan repayments under the Home Opportunity Loans Scheme.
- 63 light rail vehicles were held in excess of requirements.
- Ticket equipment valued at \$508 500 could not be located by the Public Transport Corporation.
- Port of Geelong's multi purpose berths were under-utilised.
- Funds allocated for road maintenance had reduced by 20 per cent over 4 years.
- The removal of the majority of restrictive work practices would result in savings on road activities by VicRoads of \$7.5 million per annum.
- Waiting lists, access to the Emergency Department and admittance to intensive care had deteriorated at the Alfred Hospital.

Ministerial Portfolios Report, May 1992

- The Public Transport Corporation could achieve \$13 million annual savings through greater efficiency and improved productivity at its workshops.
- Approximately \$2.7 million of Public Transport Corporation outstanding rental balances were in arrears more than 150 days.
- Increase of \$1.5 billion in the State's unfunded superannuation liability.
- The 1992-93 asset sales program has been extended to encompass the sale and lease-back of buildings valued at \$155 million which are not surplus to operational needs.
- The disposal of 2 properties was delayed with their values declining from \$29 million to \$7 million due to a decline in the market.
- Transport concession fees were abused by 11 000 pensioners.
- Rural Water commission foregoing approximately \$1.1 million in revenue.
- Daratech had a financial exposure of over \$580 000 in respect of 2 companies whose financial viability was in doubt.
- WorkCare levies in State psychiatric hospitals increased 345 per cent over the past 5 years.
- Backlog of over 650 WorkCare fraud allegations could take up to 18 months to resolve.
- A legislative loophole had the potential to cost WorkCare many millions of dollars.
- Specialised theatre equipment purchased by the Geelong Regional Commission had remained in storage since purchased in 1989.
- Maintenance and repairs to Port of Melbourne cranes could be reduced by up to \$1.2 million per year.
- State Parliamentary Refreshment Rooms unlikely to be self supporting.
- Echuca Aboriginal Co-operative Society Ltd used capital funding of \$320 000 without authority.
- The Office of the Director of Public Prosecutions could save up to \$2.1 million annually if additional prosecutors were employed in-house.
- The Department of Conservation and Environment's restructuring program was poorly planned and implemented.
- Accumulated losses of Albert Park Committee of Management totalled \$6.9 million.
- The future financial viability of Melbourne Sports and Entertainment Centre remained in doubt.
- Council of Adult Education had failed to reverse its unfavourable financial results.
- LaTrobe University maintenance costs will increase significantly in future years.
- Statistics on in-patients maintained by public hospitals were not prepared on a consistent basis.
- Escalation of Home Opportunity Loans Scheme doubtful debts to \$5.5 million at 30 June 1991.
- Revenue of up to \$4.4 million was forgone by the Traffic Camera Office.
- Decisive action required to resolve financial viability of Swan Hill Pioneer Settlement Authority.

Ministerial Portfolios Report, April 1991

- Certain inefficient work practices associated with the Construction Group in the Department of Planning and Housing significantly increased direct labour costs.
- Aggregate losses of \$31 million were incurred by the Melbourne Metropolitan Board of Works on its waste treatment plant at Tullamarine.
- The financial performance of the Melbourne Sports and Entertainment centre was deteriorating.
- State schools' funds totalling \$49.4 million was frozen in the Farrow Group.
- Accumulated losses of Government Printer totalled \$7.2 million.
- Government Employee Housing Authority acquired 460 houses in excess of its needs.
- Five nursing homes valued at \$9.5 million remained unoccupied for many months.
- WorkCare levy refunds of \$32 million due to employees over the past 5 years had not been completed.
- Domestic appliance retailing activities of the Gas & Fuel Corporation incurred a \$3.2 million loss.
- Serious irregularities occurred in the management of the Department of Planning and Housing's motor vehicle fleet.
- Retrospective expenditure approvals of \$2.4 million were sought by the Office of the Chief Commissioner of Police.
- Accumulated deficits of the National Tennis Centre totalled \$26 million.
- Tabaret became fully operational 2 years behind schedule with a budget overrun of \$19.1 million.
- Major deficiencies in the Road's Corporation evaluation of tenders for computer equipment valued at \$19.5 million.
- The Consolidated Fund debt to the State Superannuation Fund for un-reimbursed lump sum payments was \$1.1 billion.
- Aggregate losses of \$762 000 were incurred by the State Film Centre.

Ministerial Portfolios Report, May 1990

- Beneficiaries were disadvantaged from the statutory transfer of \$420 million to State Trust Corporation.
- MET buses cost \$12.8 million more to operate than contracted bus services.
- Substantial financial implications to the Port of Melbourne Authority as a result of delays in the sale of World Trade Centre.
- Serious doubts exist as to the financial viability of many water authorities.
- The Attorney General's Department had forgone \$1.1 million in interest income.
- Substantial government subsidies were required to finance the administration of Motor Car Traders Guarantee Fund.
- False documentation was used by Education Ministry to support \$7.8 million of expenditure.
- Education Ministry had a budget overrun of \$7.8 million.
- Serious overcharging by maintenance contractors at the Ministry of Housing and Construction.
- Cost of cleaning the contaminated Port of Melbourne Bayside site \$19 million.
- Self monitoring of waste discharge and stack emissions had potential for abuse by EPA licence holders.
- Outstanding warrants were valued at \$46 million.
- Potential for additional interest earnings of \$465 000 on Police Force accounts.
- Serious concerns at the protracted delays in the development of Landata.
- Serious liquidity problems associated with the National Tennis Centre..
- Excessive expenditure incurred by the Tourism Commission in operating its international offices.

Appendix D

Special performance audit reports to the Parliament

SUMMARY OF MAJOR OUTCOMES IDENTIFIED

In terms of public benefit, the performance audits performed by the Victorian Auditor-General's Office have provided an independent examination of a wide range of significant programs and activities. The benefits derived from these audits can be broadly categorised as follows:

- enhancing accountability of the Executive Government to the Parliament and the identification of risks and exposures to the State in order to highlight problems public;
- the identification of measures to improve resource management and service delivery;
- the provision of information which contributes to change;
- the suggestion of ways to reduce costs or generate revenue; and
- before they occur.

A summary of the major outcomes of performance audits are listed below. Some of these outcomes were directly attributable to audit findings while others were under consideration by management at the time of audit, with added impetus for change provided by the findings of this Office .

Protecting Victoria's children: The role of the Department of Human Services - Special Report No. 43

- Provided impetus for identifying priorities and major directives in child protection, including:
 - engagement of consultants to develop a workforce master plan;
 - ongoing placement and support service redevelopment;
 - stimulus for increased reimbursements to foster care parents;
 - enhanced child and adolescent psychiatric treatment services;
 - strengthening of intake processes;
 - ongoing research and implementation of research findings in areas of concern such as multiple placements;
 - entering into a new protocol with Victoria Police and protection workers; and
 - implementation of a child centred--family focussed case management approach.
- Minister welcomed Report, with its audit findings to be used as a key reference point for the child protection programs, strategic directives and redevelopment plans.
- Focused widespread political and public attention on deficiencies in child protection.

Arts Victoria and the Arts 21 strategy - Special Report No. 41

- Arts Victoria has since:
 - been given responsibility for all arts related matters;
 - strengthened its relationship with local government;
 - re-assessed its client relationships;
 - ensured that it more effectively identifies the needs of its clients located in the non-government sector;
 - focussed its efforts on evaluation of outcomes under Arts 21;
 - monitored the performance of non-government organisations where this was not previously done; and
 - changed its grant program management in line with the recommendations made by audit.
- The relationship between Arts Victoria and the arts agencies has better focused to enhance service delivery.
- Senior positions have been established to manage capital works programs and interaction with the arts agencies.

The Community Support Fund - Special Report No. 40

- Action was taken to enhance the accountability of the use of the Community Support Fund to the Parliament and the public.
- A review of the adequacy of funding agreements with recipient organisations commenced.
- Monitoring processes over outputs and outcomes of funded programs were strengthened.
- Legislative changes enabled moneys from the Fund to be expended on administration and evaluation of programs supported by the Fund.
- A commitment was given by the then Office of Youth Affairs to remedy deficiencies in accountability for grants from the Fund to non-government organisations.
- Action was taken by the Office of Youth Affairs to ensure that appropriate procedures were followed to support funding decisions.
- Funding from the Community Support Fund was to be separately accounted for and reported by all funded agencies.
- The Community Support Fund Unit was shifted from one of the departments that received funding from the Fund to the Department of Premier and Cabinet.

Marketing government services - Special Report No. 39

- A subsequent re-organisation resulted in the responsibility for media buying moving from the Premier's private office to the Department of Premier and Cabinet.

A competent workforce: Professional development - Special Report No.

32

and

Equality in the workplace: Women in management - Special Report No.

35

- Various issues raised in the Women in Management report were drawn upon in the Ministerial Review of Employment Equity for Women in Education.
- A limited number of scholarships were offered to certain staff who enrol in the Public Sector Management Course.

Managing parks for Life - Special Report No. 34

- In the 16 months since the Report was tabled in Parliament, the National Parks Service (NPS) has continued to implement a range of improvement initiatives as part of the major change program commenced during the final stages of the audit and referred to in the Report.
- The NPS responded positively to the suggestions contained in the Report and has undertaken significant related activities which have or are intended to:
 - improve the strategic management processes within the NPS;
 - identify and adopt best practice as the source for NPS benchmarks;
 - further develop tourism opportunities and visitor services;
 - enhance revenue management practices;
 - address a range of organisational and human resource issues within the NPS;
 - assess performance of external contractors; and
 - develop a maintenance fund for departmental housing.

International student programs in universities - Special Report No. 29

- La Trobe University implemented a business plan covering its international student programs.
- Swinburne University introduced performance indicators to its international program business plan.
- Swinburne and La Trobe commenced a marketing plan for its international student programs.
- Swinburne, La Trobe and RMIT made various changes to the management of their overseas agents.
- All 4 universities changed their systems for accounting for unpaid and late student fees.
- La Trobe resolved to specifically monitor the performance of international students.
- In line with audit's suggestions, the Federal Government took steps to establish a national marketing body similar to the British Council and universities were encouraged to undertake more joint marketing.

Legal Aid Commission of Victoria - Special Report No. 28

- The audit recommendations were taken into account as part of a major business redesign project covering the Commission's processes and programs to improve efficiency and effectiveness.
- The Department of Justice utilised the Report in conducting a review of the operations of the Commission and the delivery of legal aid services in Victoria.

Investment management - Special Report No. 26

- A new Victorian funds management body was subsequently established to centrally manage Victoria's public sector investment funds. The new authority was expected to reduce costs and increase earnings.

Aged care - Special Report No. 25

- The Department of Health and Community Services allocated additional funds amounting to \$2 million in 1993-94 and \$3 million in 1994-95 to the improvement of below standard facilities.
- Steps were taken to improve public access to aged care services, including the transfer of geriatric services to small community-based facilities.
- The Department instituted streams of care funding which has increased the output of specialised services. The new National Action Plan for Dementia Care aims to improve access and quality in the existing system.
- The Department has improved efficiency by requiring all public sector agencies to bring their cost structures in line with national benchmark levels.

Timber Industry Strategy - Special Report No. 22

- A subsequent internal review by the Department of Conservation and Natural Resources identified that 51 per cent of logs were incorrectly graded due to deficiencies identified in the Report. As a result, it was identified that between \$1 and \$2 million was lost to the State annually.

Salinity - Special Report No. 19

- A Statewide Salinity Program monitoring strategy has been finalised and individual monitoring requirements are an inbuilt feature of the State's 19 salinity management plans.
- The issue of possible land retirement and related issues covering water pricing, water use efficiency and improved technologies have been the subject of continuous deliberations at the Murray Darling Basin Commission. These issues are considered in a much wider context than salinity.

Met Ticket - Special Report No. 15

- Many of the deficiencies identified by audit were attributable to the adoption of a "fast track" method of project management. Audit understands that the report has been analysed extensively so that the past mistakes will not be repeated in the introduction of the new ticketing system for metropolitan trains, trams and buses.

Alfred Hospital - Special Report No. 12

- Following the performance audit and in anticipation of further budget cuts by the Government, a major consultancy commissioned by the hospital, which canvassed many of the issues raised by audit, resulted in annual savings of at least \$6 million to \$8 million.
- The Report findings resulted in the hospital:
 - appointing a surgeon to a part-time position of *Surgeon Wait List Co-ordinator* and a Waiting List Auditor to manage the waiting list more effectively;
 - introducing a *Pre-admission Assessment Clinic* to assess elective patients prior to admission;
 - establishing a pilot *Community Post Acute Support Program*;
 - giving priority to developing networks within general practitioners in the area and encouraging patients to use these services;
 - being allocated \$50 000 to conduct a feasibility study of its emergency department to assess the perceived shortcomings in the facility;
 - developing a detailed register of property holdings and tenancy information; and
 - selling 2 properties in East Melbourne for \$1.2 million and applying the proceeds towards the establishment of a Magnetic Resonance Imaging facility.

Land utilisation - Special Report No. 9

- Validation and recording of all properties held by the Crown and their uses commenced following the audit study. Prior to this data, property records either did not exist, were inadequate or inaccurate with substantial under-utilisation of assets occurring.
- Agencies commenced to include property management within corporate plans and objectives.
- Policy initiatives were undertaken with respect to achieving commercial returns on Crown properties and to redress restrictive and obsolete provisions within legislation which inhibited commercial returns.
- Forward planning of property requirements for operational purposes commenced, in conjunction with the development of management information systems capable of monitoring the identification and sale of surplus properties.
- The importance of accrual accounting to record all assets was strongly recommended and has since become accepted practice within government.

Foreign exchange - Special Report No. 8

- Following the disclosure of foreign exchange losses, the Government proceeded to hedge all of its foreign currency transactions.

Works contracts - Special Report No. 2

- Establishment of standard contract conditions for all authorities and departments.
- Formulation of documentation standards for all works contracts.
- Improvements in design review procedures, regulations, standards, industry consultation and project management techniques.
- Successful prosecution of the builder of the State Swimming Centre.
- Public recognition of the new role of the Auditor-General.



MAJOR ISSUES IDENTIFIED

In broad terms, the major issues raised in performance audits to date relate to:

- the inefficient use of resources;
- disclosure of programs that have proven to be ineffective;
- poor management practices involved in the monitoring and evaluation of economic, social and environmental programs;
- the identification of procedures or arrangements that pose a risk to the State and the public;
- disclosure of the financial arrangements of some of the State's largest infrastructure projects which involve the private sector, including the identification of certain potential conflicts of interest;
- excessive waiting times experienced by the users of public services;
- improvements that could be made to save money or generate savings;
- the identification of procedures designed to enhance the delivery of services to the public; and
- ways in which organisational structures, management frameworks and project management could be strengthened.

A summary of the major issues identified as a result of performance audit in recent years is provided below.

Vocational education and training: A client perspective - Special Report No. 47

- 22 per cent of Victorian respondents to a national survey indicated they had either not achieved or did not know whether they had achieved their main aim for undertaking their course.
- The Office of Technical and Further Education needs to ascertain whether the outcome for 46 per cent of respondents to the national survey, who indicated their course of study was not highly relevant to their current job, was in line with their objectives for undertaking their course.
- Very few institutes had formally obtained the views of employers in relation to the calibre of institute graduates they had employed.
- Until outcomes are accurately measured, the Office will not be in a position to conclude with any confidence whether the needs of students and industry clients have been effectively met.

**Public housing: Responding to a fundamental community
need
and
Law Enforcement Assistance Program: Better information on
crime - Special Report No. 46**

Law Enforcement Assistance Program: Better information on crime

- A number of critical problems associated with the implementation and use of the LEAP system continued to undermine the realisation of the system's full potential.
- The cost of the development, implementation and first year of operation of the leap system amounted to approximately \$50 million.

Public housing: Responding to a fundamental community need

- As 61 700 households were waiting to be allocated to public housing, there was a significant unmet need for housing assistance.
- 37 600 or 61 per cent had been waiting for more than 2 years, of which half had been waiting in excess of 4 years.
- The Department is faced with an increasing proportion of older stock with high ongoing maintenance requirements (18 500 properties had been held for more than 30 years and were in need of substantial upgrading).
- 19 000 (32 per cent) of occupied properties had potential for greater utilisation as the number of bedrooms exceeded requirements.

**Building Better Cities: A joint government approach to urban
development - Special Report No. 45**

- Very few performance measures were suitable to monitor the achievement of outcomes.
- There was no evidence to support the feasibility of proceeding with the City Circle Tram Loop.
- Scope existed to improve accountability mechanisms for future joint Commonwealth-State programs through the formulation of reporting standards.

Timeliness of service delivery: A customer's right - Special Report No. 44

- None of the agencies reviewed had developed Customer Service Charters.
- A number of timeliness benchmarks were suggested for inclusion in such charters.
- The majority of agencies did not publish their performance against key service indicators relating to timeliness.
- The Licence Simplification Program had not had a major impact on removing unnecessary burdens on business.
- Victoria Legal Aid's deteriorating financial position will adversely impact on the provision of legal aid to clients.

Protecting Victoria's children: The role of the Department of Human Services - Special Report No. 43

- In some regions up to 20 per cent of cases were closed despite circumstances warranting further investigation.
- 32 per cent of all notifications of suspected child abuse or neglect during 1993-94 were re-notifications.
- Weaknesses existed in relation to the depth and calibre of investigations by the Department of Human Services and in the evaluation of the risk of significant harm to children.
- Factors contributing to ineffective case management include:
 - high workload levels and turnover of case workers;
 - delays in the allocation to workers of cases; and
 - an inadequate emphasis on the provision of counselling and therapy services to the child and its family.
- Preventable harm had been caused to children as an indirect result of policies or programs designed to provide care and protection. In other words, "system abuse" of children has occurred in Victoria.
- Many problems impeded a cohesive working relationship between Victoria Police and the Department and, in turn, limited their capacity to adequately protect children. An integrated approach needs to be developed to deal with children in care frequenting streets.
- The impact of children remaining in facility-based care for extended periods can be extremely damaging to a child in the longer-term.
- Around 26 per cent of children under the care of the State for more than 3 years were not living in permanent care arrangements.
- In some cases children were returned to families who had not demonstrated a willingness to rehabilitate their lives.
- An excessively long time was taken by the Department to complete and report to the Parliament on inquiries into deaths of children under care or subject to investigation of protective concerns.

**Arts Victoria and the Arts 21 strategy: Maintaining the State for the Arts
- Special Report No. 41**

- Arts Victoria had not been in a position to satisfactorily pursue its responsibilities to co-ordinate portfolio-wide arts matters within the framework of Arts 21, principally because of a less than cohesive internal relationship with the Resource Management Division of the former Department of Arts, Sport and Tourism.
- Overly-intrusive framework agreements further impeded the situation.
- Arts Victoria needs to establish specific performance targets for its service categories.

**The Community Support Fund: A significant community asset -
Special Report No. 40**

- Involvement by the wider community in decision-making processes for determining distributions from the Fund had been very limited.
- The Report suggested a Board of Management-type structure comprising a broad representation of community interests.
- It would seem logical and equitable that clubs and the casino be required to make statutory contributions to the Fund to be used in addressing the social ramifications of gaming.
- An aggregate outlay of just \$364 000 or 0.6 per cent of total expenditure from the Fund on research into the social impact of gaming over the first 3.5 years of the gaming industry was seen by audit as inconsistent with the legislative emphasis.
- The broad nature of the legislative definitions of community programs or projects eligible to receive assistance make it very difficult to form definitive judgements regarding the relative merit of individual funding decisions.

**Marketing government services: Are you being served? -
Special Report No. 39**

- Some campaigns, such as the electricity supply industry privatisation advertising campaign, had not met their objectives.
- In relation to general marketing, planning and management were found to be poor.
- Negotiations with advertising agencies need to be strengthened with a view to achieving more advantageous financial arrangements.
- Procedures for the selection of the Government's media buying contractor were poorly documented and a public tendering process was not adopted.
- Examples were identified, particularly at a central level, where published material was, in audit opinion, totally inappropriate as it contained party-political statements. In other cases media advertisements or publications were used to enhance the image of the Government.

- The Report suggested that there is a need for conventions to be set in place covering publicly-funded advertising and promotion which need to have the support of all political parties.
- There was a need to locate the Communication Unit within the departmental structure rather than in the Office of the Premier, to avoid any perception of political influence on advertising or media buying.

**Privatisation: An audit framework for the future -
Special Report No. 38**

- The Report, in outlining an audit framework for the future, promoted sound management practices for subsequent privatisations and enhanced accountability in terms of the processes implemented by the Government to date.
- A comparison was made as to what constitutes government policy in the view of the Auditor-General and the Department of Treasury and Finance and the impact of the varying views on the audit coverage

**Promoting industry development: Assistance by government -
Special Report No. 37**

- There was a need for the formulation of specific targets for export growth, import substitution and increased employment pursued under the Program.
- Although import substitution was identified as a priority source of economic benefits, emphasis had been directed towards projects with a direct export outcome.
- Various industry sectors need to be prioritised to provide a sounder basis for directing resources.
- The quality of information submitted by the Strategic Industry Research Foundation on its achievements needs improvement.

**The changing profile of State education: School reorganisations -
Special Report No. 36**

- Not all schools were formally assessed against the *Quality Provision Framework*.
- The reorganisation process was primarily directed at cutting costs rather than improving student learning opportunities.
- The recommendations of some local Task Forces were influenced by the preferred options of the Directorate of School Education and the requirement for the Minister to ultimately decide whether changes were necessary and desirable.
- A post-implementation review to assess the effectiveness of school reorganisations had not occurred.

Equality in the workplace: Women in management - Special Report No. 35

- Women were under-represented in management (25 per cent) compared to their proportion of the workforce (42 per cent) or the community (51 per cent).
- According to public sector employees, equal employment opportunity had not been provided to some women and certain cultural attitudes discriminated against women advancing to managerial positions.
- Flexible work arrangements had not been widely introduced.

In terms of outcomes, the Public Service Commissioner acknowledged that in response to the Report, scholarships to EEO groups would be offered to attend the Public Sector Management Course. Various issues raised were drawn upon in the *Ministerial Review of Employment Equity for Women in Education*.

Managing parks for life: The National Parks Service - Special Report No. 34

- The unco-ordinated and rather haphazard approach to strategic management in the past meant that the Service could not assess its own effectiveness, clarify goal setting and adopt a structured approach for decision-making.
- Opportunities to capitalise on tourist development or improve service delivery were not always considered.
- The Service's policy setting on the diversity of opinion on conservation versus tourism/recreational issues in parks should be clearly manifested in a tourism strategy.

Handle with care: Dangerous goods management - Special Report No. 33

- It is important that agencies with inspection and enforcement powers utilise resources effectively and in a manner which best protects the interests of the public.
- There audit saw merit in the proposal to rationalise legislation.
- None of the regulatory agencies had undertaken a comprehensive assessment of risks.
- A large proportion of dangerous goods operators had not met requirements to obtain fire protection reports, develop emergency plans or maintain manifests detailing the type and quantity of dangerous goods held on their premises.
- Even though some dangerous goods operators were in breach of regulations, they were permitted to operate while the matter was being addressed.
- The effectiveness of the Occupational Health and Safety Authority's enforcement strategies as a preventative mechanism had been reduced by its reluctance to revoke a licence or to force a business to cease operations, even in cases of repeated non-compliance.

A competent workforce: Professional development - Special Report No. 32

- Mechanisms to ensure that the Government obtained maximum value from its investment in training and staff development had not been appropriately established.
- At a central government level the Office of the Public Service Commissioner could enhance its role by:
 - assessing whether the Government is exposed to any material risks emanating from its professional development practices in areas such as outsourcing and health and emergency services; and
 - releasing information to departments on best practice.
- Detailed performance indicators for key program outcomes, linked to defined staff competencies, were lacking.
- It was essential that course participants be selected on the basis that the newly acquired skills will be used on a frequent basis.
- Participants need to be consulted as to their training objectives and current competencies prior to attendance at training courses.
- An assessment needs to be made as to whether on-job-training would be more suitable.
- Training needs to be linked to corporate goals, human resource development plans and career plans of staff.

Purchasing practices - Special Report No. 31

- There has been an undue emphasis on purchasing processes, rather than on outcomes such as the achievement of value-for-money objectives.
- A flexible environment where optimum benefit could be made of innovative developments in purchasing such as partnering arrangements had not been created.
- Audit strongly supported the proposed creation of a Government Purchasing Board.
- At an agency level attention needed to be given to a range of areas such as improving selection processes and contractual arrangements, and adopting a purchasing method which arrives at the best value-for-money.

Grants and subsidies to non-government organisations - Special Report No. 30

- Given the change in government that occurred in October 1992, the 1988 guidelines for the management of grants and subsidies should have been reviewed in the light of the newly appointed government's policies and initiatives.
- The 2 central agencies had not undertaken a comprehensive cross-sectional risk assessment of the key elements of government policy. As a consequence the Government was not in a position to reach valid conclusions on the materiality of its exposure to various risks associated with the management of grants and subsidies.
- The efficiency and effectiveness of service delivery within the Department of Health and Community Services was likely to have been adversely affected by:
 - the absence of an effective framework incorporating performance standards and monitoring mechanisms within some programs;
 - the continued funding of some NGOs on the basis of historical costs;
 - poor asset recording by NGOs;
 - a lack of competition in the provision of services; and
 - performance not legally enforceable.
- As an outcome of the Report the guidelines were reviewed which took into account the suggestions outlined in the Report.
- International Student Programs in Universities - Special Report No. 29
- Certain practices of universities posed risks to the safeguarding of academic standards as the minimum entry standards for university courses in terms of overseas qualifications were not consistently applied between universities.
- Minimum entry standards were not consistent between universities relative to VCE cut-off scores.
- Various matters were suggested by audit for consideration by the Commonwealth Government to strengthen the future administration of international student programs from a national perspective.

International student programs in universities - Special Report No. 29

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Legal Aid Commission of Victoria and Office of the Valuer-General - Special Report No. 28

Legal Aid Commission of Victoria

- This performance audit was undertaken following a request from the Attorney-General of Victoria.
- The public no longer had the same access to legal aid and other Commission services due to the continuing increases in the cost of legal services provided by private practitioners and the increasing complexity and cost of the legal system.
- Some of the suggestions made by audit to improve service delivery included:
 - methods to evaluate and prioritise legal aid services to ensure that priority needs of clients are properly targeted;
 - tendering aimed at achieving competitive market rates for private legal practitioner services; and
 - opportunities designed to increase revenue from other sources.

Office of the Valuer-General

- The audit revealed that there was a need for the operations of the Office to be reviewed to ensure that the structure and level of resources was appropriate and that various guidelines provided adequate protection against risk.
- In some areas the fees charged varied considerably from those charged by private sector valuers.

Management of heritage collections - Special Report No. 27

- Limited progress achieved in implementing the recommendations arising from prior reviews of the Museum of Victoria, the National Gallery of Victoria and the State Library of Victoria.
- To optimise the value to Victoria of the State's heritage collections there was a need for a greater level of strategic planning and policy determination in relation to collection management.
- Storage facilities were totally inadequate. As such the safety and condition of the collections were at risk.
- There was an opportunity to improve security and disaster planning at the Museum and Library.
- To a large extent all 3 collections remained unvalued.
- There was scope for significant cost savings to be achieved through the consolidation of off-site storage facilities.

Investment management - Special Report No. 26

- The decline in the property market contributed to poor returns experienced by some agencies.
- From a Statewide perspective, the monitoring of risks had been substantially ignored.
- Significant deficiencies were found in the central information procedures for monitoring investments made by agencies.
- The Department of Treasury was not in a position to quantify the overall risk exposures of the Government or to promptly evaluate the impact of any major change in government policy or sudden fluctuations in market conditions.
- Significantly improved returns on investments would be achieved if all agencies received returns on their investments in line with those achieved by the Transport Accident Commission.

Aged care - Special Report No. 25

- The lack of strategic direction, needs-based planning and standard setting and the Department's inability to react to the changing demands of such services contributed to the inefficient and ineffective use of resources.
- Various improvements could be made to the overall quality of life of residents in geriatric centres and public nursing homes.
- Access to residential aged care services was restricted.
- The aged care needs of older people with specific needs were in some cases not adequately addressed, particularly in relation to respite and dementia care.
- Significant waste of taxpayers' funds in relation to the provision of nursing and hotel services e.g. during 1991-92 the costs involved in providing nursing home services were more than \$100 million higher than the private sector.
- Some facilities held substantial parcels of property surplus to their needs which, if sold, would generate funding to enable more services to be relocated to community-based settings.
- The extent to which aged care facilities provided protection from fire hazards was affected by their physical structure.
- The Report included numerous suggestions for improvement which included the need for greater attention to be given to providing adequate measures for the safety of older people that reside in outdated buildings.

Open cut production in the Latrobe Valley - Special No. 24

- The existence of unwarranted restrictive work practices and demarcations between employees in different unions and work groups led to ineffective operational practices and costly maintenance of significant capital investment.
- Potential savings of \$50 million per year were identified through:
 - a reduction in workforce levels by achieving greater productivity; and
 - the more effective utilisation and maintenance of plant.
- There was a need to improve environmental management within open cuts by more effective strategic planning in relation to land rehabilitation, including greater consideration of future environmental funding requirements.

The various matters raised were designed to provide the former State Electricity Commission Victoria with opportunities for achieving improvements in the efficiency and effectiveness of its operations.

Information technology in the public sector - Special Report No. 23

- The Report focuses on the illegal use of proprietary software, management controls over software usage and gross inadequacies in the development of sector-wide human resource management information systems.
- The Report identified the failure of government agencies to address fundamental IT controls which exposed the Government to the risk of excessive costs, ineffective systems and penalties.
- As the Government moves to contract out IT services, the Report warned that it will be even more important to ensure that adequate IT standards be promulgated by the Government to ensure that private sector providers do not repeat the mistakes identifies from the audit.

Timber Industry Strategy - Special Report No. 22

- The rate of return from forest operations remained well below the target of 4 per cent.
- Only limited progress had been made towards the completion of integrated forest management plans.
- The anticipated expansion of private forestry and the reforestation of public land had not been achieved.
- The Report called for greater emphasis to be placed on a range of measures which included strengthening the processes for grading and allocating the State's native hardwood timber.

Zoological Board of Victoria

- There was a lack of strategic direction and an indecisiveness in managing change and implementing initiatives.

In terms of outcomes, following the completion of the audit the Board prepared a detailed action program and recommendations were implemented with positive results.

Visiting Medical Officer arrangements - Special Report No. 21

- Controls over expenditure on VMOs, which amounted to \$120 million annually, were inadequate.
- Appropriate measures to remedy the accountability deficiencies or to pursue cost savings, previously identified by the former Economic and Budget Review Committee up to 8 years prior, had not been implemented.
- VMO practices in public hospitals resulted in a significant wastage of taxpayers' funds.
- Some of the inappropriate features of VMO arrangements related to :
 - payments for services not supported by documentary evidence that the services had been provided;
 - *prima facie* evidence of over-servicing;
 - *prima facie* evidence of VMOs working privately while on paid sick leave;
 - evidence suggesting a bias against the admission of public patients for elective surgery;
 - significant potential to reduce health costs through the greater use of sessional VMO arrangements as opposed to the existing fee-for-service arrangements; and
 - improper shifting of State health costs to the Commonwealth and the *prima facie* evidence of irregularities in Medicare payments to VMOs.

National Tennis Centre Trust and Zoological Board of Victoria - Special Report No. 20

National Tennis Centre Trust

- This audit was undertaken at the request of the former Economic and Budget Review Committee.
- The costs incurred by the end of construction amounted to \$94 million.
- As a result of the financing arrangements to meet these costs, the Trust faced substantial debt obligations and mounting operating deficits.
- The support package put in place did not represent the most cost-effective arrangement for assistance to the Trust. An alternative arrangement could have resulted in a reduction of \$20 million in outlays from the Consolidated Fund.
- The requirement for the Trust to engage Tennis Australia to manage the Centre created potential for Tennis Australia to be placed in a conflict of interest situation.

Salinity - Special Report No. 19

- Past government decisions on land development have in certain regions contributed to the salinisation of land and water.
- While in excess of \$150 million had been expended on the Salinity Control Program, the Report called for difficult decisions to be made in relation to :
 - possible land retirement;
 - the long-term use of evaporation basins;
 - the appropriate level of contributions to be made through the adoption of the beneficiary pays and polluter pays principles; and
 - the development of a central monitoring framework to assess the effectiveness of the Program.
- The Government could have taken a more active role in reviewing the progress of salinity management plans as some plans took a protracted amount of time to finalise at a cost far in excess of that estimated.

Bayside development - Special Report No. 18

- At the date of audit the project cost Victorian taxpayers over \$70 million without a firm contractual relationship between the Government and the developer (Sandridge City Development Company Pty Ltd).
- The future of the development was in considerable doubt due to difficulties experienced by the developer in finalising the necessary finance.
- In negotiation processes between the Government and the developer most of the significant concessions were made to the disadvantage of the Government.
- Doubt surrounded whether the social and economic benefits anticipated by the Government would be realised.
- In financial terms the substantial outlays and risks to the Government far exceeded the return.
- The treatment of extensive contamination of the site delayed the project by 4 years.
- The procedures followed in selecting the preferred developer did not include adequate analysis of the financial viability of the proposed developments or of the financial strength of the selected developer.
- In relation to outcomes, this Report succeeded in providing Parliament and the public with a completely impartial analysis of the current status of project negotiations, despite criticism of possibly jeopardising the proposed development.

Integrated education for children with disabilities - Special Report No. 17

- A considerable number of students were not provided with the level of resources necessary for integration into the regular school system.

Fire protection - Special Report No. 16

- Weaknesses were found to exist in strategic management processes, particularly with regard to fire prevention, which raised serious concerns about the State's firefighting capability in particular areas of the State.
- Many of the State's important fire access tracks were in a very poor condition.
- Levels of forest undergrowth were up to 7 times greater than departmental targets, particularly in high risk zones.
- About a third of the Department's firefighting equipment was obsolete; replacement would cost \$4.5 million.

Met Ticket - Special Report No. 15

- Substantial effort and costs were incurred in the development and implementation of Met Ticket with only minimal benefit to public transport users and the Government.
- The absolute minimum net cost to the State of this attempted government initiative was around \$11 million which did not include various significant items such as loss of patronage, fare evasion, vandalism to trams and costs associated with industrial disputation.
- Various government goals were not achieved.
- Only minimal consultation occurred with unions prior to the introduction of Met Ticket, which contributed to industrial action over a 5 week period.
- Financial projections were flawed in various respects.
- The design of the scratch tickets and the concept of self validation contributed to an increase in fare evasion.
- There was a significant decline in patronage and fare revenue after scratch tickets were introduced.
- A range of poor practices were adopted in the advertising campaign.
- Various inefficient practices were identified in the printing and distribution of tickets such as an excessive number of tickets were printed and reconciliations of cash with unused tickets were not undertaken in some cases.
- There was insufficient market research and consultation with the elderly and the disabled.
- Unnecessary expenditure amounting to \$600 000 was incurred in modifying trams to driver-only.

In terms of outcomes, many of the deficiencies were attributable, in part, to the adoption of a "fast track" method of project management. The report has been analysed extensively so that the lessons learnt will not be repeated in the introduction of the new ticketing system for metropolitan trains, trams and buses.

Accommodation management - Special Report No. 14

- The under-utilisation of many government-owned facilities for extended periods occurred at the same time substantial costs were incurred in leasing premises from the private sector.
- Many buildings were in a run-down condition.
- Unnecessarily high levels of dead-rent were incurred due to delays in the fit-out process.
- The Government's commitment to many long-term lease arrangements exposed the State to the risk of increases in leasing costs in line with future market trends.

State Bank Group: Impact on the financial position of the State - Special Report No. 13

- In response to the Legislative Council resolving that the Auditor-General inquire into the financial affairs of the State Bank Group in so far as they impact on the financial position of the State, it was found that the potential impact on the Consolidated Fund at the time of audit in terms of the assumption of debt was up to an amount of \$795 million together with interest.

Alfred Hospital - Special Report No. 12

- Extreme demand on intensive care facilities meant that one in every 3 critically ill patients could not be treated in the hospital's intensive care unit and had to be transferred to other areas for treatment.
- Incidences of ambulance bypass could have impacted on optimal patient care.
- Critical comment was made in relation to waiting list numbers and waiting times, lengths of stay and the treatment of privately insured patients in public hospitals.
- Benchmarks in relation to waiting times, critical care and emergency services were not in place.
- Property management was poor in that \$29 million of property holdings (25 per cent), which included the Chevron Hotel, were not used for hospital purposes.
- Cost savings of \$2 million per annum were identified in the catering and cleaning functions.
- Proceeds from the sale of surplus properties and improved work practices could be directed at treating patients.
- The re-use through re-sterilisation of medical and surgical items, designated as single-use by manufacturers, created potential health risks.

In terms of outcomes, from an accountability viewpoint the report highlighted various pressures that the hospital faced in providing medical services, the majority of which are still present. Various improvements have been implemented in managing the hospital's properties and benchmarks have been established under the casemix funding system.

Appendix E

Current work program of Victorian Auditor-General's Office - Outcomes to be reported to the Parliament

PERFORMANCE AUDITS

- Casemix funding of Public Hospitals
- Schools of the Future
- Management of gaming industry - Role of Victorian Casino and Gaming Authority
- Child care and kindergartens
- Major civic projects (including Agenda 21 projects)
- Ambulance services
- Public Transport Reform Program
- Bureau of Emergency Service Telecommunications (Intergraph system)
- Police Customer Service Strategy
- Privatisation of Government Business Enterprises
- Outsourcing in the public sector

SPECIAL REVIEWS

- Electricity industry privatisations - Sale of Hazelwood and Energy Brix
- Settlement of Petroleum Rent Resource Tax dispute
- WorkCover reforms
- Disaggregation of the Port of Melbourne Authority
- Municipal council divestment of retail properties
- Joint commercial development projects at Monash University
- Management of corporate cards used by departments
- Information security management within the public sector
- Country Fire Authority management information system implementation
- Public Transport Corporation revenue protection measures
- Review of Alpine Resorts Corporation
- Corporate governance in the public sector

Appendix F

Previous independent performance audits of the Victorian Auditor-General's Office - Key conclusions

Auditing in the Public Interest: A Performance Audit of the Victorian Auditor-General

(September 1995)

This report was prepared by Mr Alan Talbot, Partner of Price Waterhouse, who was appointed by the Parliament's Public Accounts and Estimates Committee to undertake a comprehensive performance audit of the operations of the Auditor-General and his Office, in accordance with section 19(1) of the *Audit Act* 1994. The key conclusions of the report were as follows:

OPINION AND CONCLUSIONS

1. I have conducted a Performance Audit of the Victorian Auditor-General's Office ("the Office") for the three years ended 30 June 1995. This has included an examination of the performance of the Office in the conduct of:
 - Financial Statement Audits, which I have compared with the Big 6 accounting firms in Australia (Big 6);
 - Performance Audits, which I have compared with Public Sector Performance Auditing in Canada and the United Kingdom; and
 - Human Resource and Administration matters, which I have compared with the Big 6.

In my opinion, during the three years ended 30 June 1995, the Auditor-General has achieved his objectives effectively and done so economically and efficiently and in compliance with the Audit Acts 1958 (as amended) and 1994 respectively.

2. I have concluded that the quality of the Auditor-General's opinions on Financial Statements is of a high standard and the work practices and documentation are close to that of the Big 6. Areas which require improvement are:
 - efficiency; where planning is often late and insufficient use is made of technological solutions; and
 - customer service; which is not, in my view, as good as in the private sector where competition for clients is intense.

3. Overall the Office is conducting Performance Audits effectively and efficiently. The quality of Performance Audits is good especially taking into account the limited resources available. Better performing offices such as the Office of the Auditor-General of Canada and the National Audit Office in the United Kingdom have far greater resources and are generally ahead of the Victorian Office in the development and practice of Performance Auditing, while Australian State and Canadian Provincial Audit Offices are generally well behind Victoria. Although Victoria is performing well there are areas where I believe certain key improvements should occur, such as:
 - project management, where a more effective system is required;
 - aspects of the audit approach, where more attention should be given to establishing high level performance criteria and discussing them with auditees, and where greater use of outside experts should be made; and
 - cost effectiveness of reporting where, in line with overseas trends, creative solutions are required to reduce the high proportion of time and cost.

More action by the Public Sector in measuring its own performance would enable more effective auditing.

4. The most difficult matter which has arisen from this audit has been to determine how much performance auditing is appropriate in the circumstances. Because of tight resource constraints the staff of around 30 people can achieve only a modest coverage of the Public Sector. Whereas the frequency and scope of Financial Statement Audits are well established and understood worldwide, no such situation exists with Performance Audits. Because there is no recognised standard or objective measure of 'how much is enough' I believe it is up to Parliament to determine whether it wants more Performance Auditing than it is presently getting. It is my personal view that progressively increasing the resources for Performance Auditing by 30% a year towards the same level as financial statement auditing is practical and desirable, and together with some changes in approach, would ensure a greater coverage than the modest level now obtained. Increased performance auditing should also pay its way in terms of direct cash savings.
5. The Auditor-General's recommendation in the 1995 Report on Ministerial Portfolios that better performance measurement is required by Government is extremely important and needs every support and encouragement. It is no easy matter getting the whole Public Sector to determine high level performance criteria, to have them accepted at all levels and agreed by the Auditor-General. To then develop detailed performance indicators and measurement standards and to properly measure performance is time consuming and difficult. If this occurred the Auditor-General's performance audit task would become quicker and more effective because the Office would then be auditing the process rather than having to carry out most of the process before forming a view.

6. The previous Performance Audit by Mr Fergus Ryan recommended an improvement in the client service relationship with auditees. Differences have arisen between survey results, which have generally been good, and interviews and other anecdotal information which indicate that client service relationships with auditees are still in need of improvement. Some of this can be explained by the fact that a higher proportion of this information is from those who wish to complain, whilst one does not hear much from the satisfied majority. Another possible explanation is that survey results, particularly from Parliamentarians, may be favourably biased because Parliamentarians are properly very supportive of the office of Auditor-General and do not wish to criticise it.
7. Because the Auditor-General is in the enviable position of having a captive client base it is particularly important for the office to ensure that its treatment of Auditees is professionally impeccable and that service levels to Auditees are at least as good as the Big 6 where competition ensures good service. I am recommending that the recently instituted auditee satisfaction surveys be regularly conducted by the Office, and that the process should include discussion by senior management not involved in the audit, with the chief executive's of Auditees.
8. Human Resources and Administration are generally well managed by the Office, and quality is good especially considering public sector salary constraints which put the Office at a competitive disadvantage. Areas for improvement include:
 - more efficient use of technology; and
 - more focussed training.
9. In order to gauge satisfaction with the Auditor-General's Office, I conducted a survey of all 150 Parliamentarians. The survey asked Parliamentarians to rate the importance of a number of performance indicators and to rate their level of satisfaction with the performance of the Auditor-General against these indicators. I received responses from 48, for an overall response rate of 32 %. The overall assessment of the Auditor-General's Office by Parliamentarians responding to the survey was very positive. 69% of respondents were very satisfied rating their satisfaction 6 or 7 on a 7 point scale and view the Auditor-General's Office as a valuable resource to the State of Victoria.
10. I also conducted a survey of auditees to evaluate the performance of the Auditor-General's Office in conducting audits. Of 60 auditees surveyed, 45 or 75 per cent responded. Overall satisfaction of auditees was lower than that Parliamentarians. Only 28% of auditees, as compared with 69% of Parliamentarians reported that overall they were very satisfied (a rating of 6 to 7 on a 7 point scale). However, almost all (80%) auditees rated their satisfaction as 4 or more on a 7 point satisfaction scale. Auditees were asked to rate the performance of the Auditor-General's Office on a number of attributes on seven key factors. As shown in Appendix B [of Mr Talbot's Report] auditees were more satisfied with the engagement team, technical knowledge, and sensitivity of the Auditor-General's office than with the proactivity, business perspective and value for money provided by the Office.

11. A different type of survey enabled me to gather information from the National Audit Office and the Audit Commission in the United Kingdom, the National and certain Provincial Audit Offices in Canada and the National and State Audit Offices in Australia. The information obtained from this survey together with my visit to Audit Offices in Canada and the United Kingdom and expert advice from a Canadian expert has enabled me to place the performance of the Victorian Office in some perspective. Many of the problems being found in Victoria are similar across the Offices and solutions are increasingly being shared. I have formed the view that, in relation to Performance Audits, the Victorian Office is well to the forefront amongst smaller audit offices but has difficulty competing with the large National Audit Offices because of the much smaller scale of operations and resources.
12. Price Waterhouse has achieved Independent Quality Certification to Australian Standard AS 3901 and International Standard ISO 9001 for all of its Australian offices and products. Most other Big 6 firms and a growing proportion of large private sector companies either have, or are engaged in seeking, quality accreditation. Great benefit is gained from carefully defining the basics followed by steady 'continuous improvement' which is forced by the process. Some companies have gone further and adopted one of the more demanding, time consuming and expensive Quality Management methodologies which promise even greater benefits. I consider that the Office of Auditor-General is well suited to seek quality accreditation and that the continuous improvement process would be extremely beneficial over a three year period. Adoption of one of the more demanding methodologies could be considered after a few years experience with continuous improvement under AS 3901. The Auditor-General should be, and be seen to be, at the leading edge of quality performance.
13. The Office of the Auditor-General is well placed to meet the challenges of the next few years after two years of major restructuring. The Corporate Plan and Business Plans are adequate and appropriate to the stage of development of the Office. The people are highly motivated, the methodologies are basically sound and the management processes satisfactory. Significant improvements have occurred over the three years since the previous performance audit, but these have been necessary to keep pace in a fast changing, competitive environment. It will be a continuing challenge to audit the Public Sector in Victoria. The greatest achievement has probably been in the cost effectiveness of financial audits, a high percentage of which are contracted out to agents in a well managed manner. The biggest challenge is in Performance Auditing where resources have always been too low to provide a realistic coverage of the Public Sector, where performance measurement in the Public Sector is lacking and where the theory and practice of performance auditing are not well established or agreed worldwide.

The Auditor-General and the Office are to be commended on their achievements in a difficult period of change.

Report on Performance Audit of the Auditor-General of Victoria pursuant to Section 48B of the Audit Act 1958

August 1992

This report was prepared by Mr Fergus Ryan, Managing Partner of Arthur Andersen, who was appointed by the Parliament's Economic and Budget Review Committee to undertake a comprehensive performance audit of the operations of the Auditor-General and his Office, in accordance with section 48B of the *Audit Act* 1958. The key conclusions of the report were as follows:

EXECUTIVE SUMMARY

I. Background

In the Westminster system of parliamentary democracy the Parliament has control of the public purse. The Executive can only expend funds which have been appropriated to it by Parliament, and it is accountable to Parliament for expenditure in accordance with Parliament's authorisation. The Auditor-General's traditional role in the accountability process is to provide an independent attestation to Parliament of the Executive's statements of account.

The functions of the Auditor-General of Victoria are established by the Audit Act 1958, as amended. Those responsibilities can be summarised as auditing the accounts of government departments and publicly-owned bodies ("financial audits") and conducting audits of the effectiveness, efficiency and economy of the operations of public sector entities ("performance audits").

The Auditor-General is responsible for the audit of approximately 550 entities, including some very large statutory authorities such as the State Electricity Commission, Gas and Fuel Corporation and the State Insurance Office. To assist him in discharging his responsibilities there exists the Office of the Auditor-General. The Office currently comprises approximately 160 personnel and has an annual expenditure of \$14 million.

II. Approach to the Engagement

My terms of reference clearly require me to undertake a review of the way in which the Auditor-General conducts financial and performance audits. I have therefore reviewed the Office's financial and performance audit methodologies by reference to Australian auditing standards and "world best practice". I have also undertaken a detailed review of a number of specific financial and performance audit engagements.

In addition, I have spent a considerable amount of time obtaining the views of representatives of the wide range of groups who come in contact with or make use of the work of the Auditor-General. The "effectiveness" of the Auditor-General is ultimately a function of the benefits derived from his activities.

The application of a risk-based audit methodology requires an evaluation of pervasive (or system-wide) risks and controls as a necessary precursor to audit planning. This is the process which enables the auditor to focus audit effort on areas of most risk (or potential benefit) and, consequently, to make best use of scarce resources.

In Victoria, the Central Agencies (Department of the Premier and Cabinet, Department of Treasury, Ministry of Finance, and the Public Service Board) have primary responsibility for system-wide risk identification, monitoring and control. Consequently, my evaluation of the Auditor-General's planning process commences with a review of the role of the Central Agencies.

I have also reviewed the administration of the Office, focusing primarily on matters of personnel management and training, productivity and use of information technology.

III. Conclusions

Before summarising my principal conclusions, it is important to appreciate that the Office is currently in something of a period of transition. It has recently introduced new methodologies for both financial auditing and performance auditing. Amendments to the Audit Act passed in 1990 formalised and expanded the performance audit mandate.

I am in no doubt that the Office is heading in the right direction in both its auditing and its administration. My comments and recommendations are intended to contribute to that process.

IV. The Auditor-General's Approach to Risk Assessment

In order to ensure that the auditor focuses his efforts on those areas of the auditee's operations which are most likely to give rise to problems or other issues relevant to the audit, he undertakes a process called "risk assessment". Risk assessment involves:

- gaining an understanding of the environment in which the auditee operates and the nature of its business;
- determining the risks that the auditee is therefore exposed to; and
- identifying the controls, if any, which the auditee has established to mitigate those risks.

The Central Agencies have some risk assessment and control responsibilities which extend across the public sector as a whole, and therefore affect all or significant parts of the Auditor-General's base of auditees.

The Auditor-General should, therefore, firstly assess how effectively the Central Agencies are fulfilling these responsibilities before planning the audits of individual auditees. By taking this approach, he will be better able to identify where problems and issues are likely to arise across his auditee base. He will also be better able to contribute to the prevention of problems, rather than their identification.

V. Relationships with Parliament and the Executive

The following changes are recommended to clarify the proper relationships between the Auditor-General, Parliament and the Executive.

I would expect that the responsibilities of Parliament recommended below would in the first instance normally be discharged through an appropriate Parliamentary body such as the Economic and Budget Review Committee.

1. The Auditor-General should be appointed on the nomination of Parliament, not of the Executive (Section IV. 1 page 13).
2. The budget of the Office should be approved by Parliament through a specific appropriation, rather than being subject to review by the Executive through the normal annual budgetary processes (Section IV. 1 page 15).
3. Parliament should be responsible for endorsing a Corporate Plan for the Office which would include a clear articulation of the Office's objectives. The absence of an expression by Parliament of the Auditor-General's objectives makes it impossible for either the Auditor-General or myself to come to a clear view on whether Parliament's needs and expectations are being met (Section IV. 1 pages 15-16).
4. Parliament should review the annual performance audit plan, and should be able to recommend (but not require) subjects for audits (Section IV.1 pages 15-16).

VI. Financial Audits

The Office's financial audit methodology is consistent with current audit thinking and complies with Australian auditing standards. Appropriate steps have been taken to control the quality of implementation of the methodology.

Because of the Office's performance auditing responsibilities, the planning for most financial audits does not begin until near to, or in some cases after, the auditee's balance date. This results in a lack of flexibility in choosing the most efficient and effective approach to each audit. Auditees are concerned that late planning also results in late identification and resolution of issues. I therefore recommend that the planning for financial audits commences far earlier in the financial year.

There are some specific aspects of the execution of financial audits which can be improved. They are:

1. use of sampling techniques (Section V.2 - 2.1 page 32);
2. determination and documentation of audit scopes and materiality levels (Section V.2 - 2.2 page 32);
3. integration of EDP risk evaluation into the audit process (Section V.2 - 2.3 page 32);
4. clearer identification of the linkages between risk evaluation and audit approach (Section V.2 - 2.4 page 33);
5. enhanced post-balance date review processes (Section V.2 - 2.5 page 33); and
6. more actively seeking out opportunities to make use of internal audit work (Section V.2 - 2.6 page 34).

VII. Performance Audits

The Office's performance audit methodology is advanced in development by world standards, and its application to specific engagements is generally of a high standard.

Specific recommendations include:

1. Improving the process of selecting subjects for performance audits by:
 - i. performing more audits of subjects such as labour costs and information technology which are relevant to a number of auditees (or are in common to the Public Sector as a whole), as opposed to audits of particular entities or parts of entities, thereby gaining better coverage of those issues of most importance overall;
 - ii. advising auditees of subjects which have been identified in the Master Audit Plan as being worthy of performance audit. The Master Audit Plan currently identifies over 2,000 potential performance audits. Notifying management of potential audit subjects should encourage them to initiate their own investigation, thereby realising some benefit before the Office is able to undertake the audit (because of the volume they may never be in a position to cover all of these issues); and
 - iii. selecting some audits in the expectation of identifying "best practice" (Section V.3 - 1.3 page 39).
2. Continued enhancements in the preparation and presentation of performance audit reports, including:
 - i. developing an improved style of Executive Summary which would convey the objectives, scope, significant conclusions and significant recommendations of the audit, in a more balanced manner (Section V.3 - 5 pages 43-45);
 - ii. developing recommendations to either address identified problems or prevent them from reoccurring (Section V.3 - S pages 43-45); and
 - iii. enhancing communication with auditees during the report writing process (Section V.3 - 5 pages 43-45).
3. The institution of a peer review process (Section V.3 page 37).
4. Continuation of the efforts of the Office to broaden the skill base of performance auditors, including periods of secondment as an integral part of each auditor's professional development (Section V.3 - 4 pages 42-43).

VIII. Relationships with Auditees

My discussions with auditees identified some issues which were raised consistently as giving rise to tensions in relationships with the Auditor-General and which, consequently, have the potential to hinder the effectiveness of his work.

The principal issues can be summarised as:

1. Client Service

Client service can be defined as the process of determining what the needs and expectations of your client are, and then striving to meet or exceed these needs and expectations. The Auditor-General, quite properly, places considerable importance on the delivery of quality client service to Parliament. However, it was evident from the feedback from auditees that the same focus on client service is not generally brought to the Auditor-General's relationships with them.

The more effective and efficient are the operations of public sector entities, the greater is the benefit to the State as a whole. Consequently, I believe that the Auditor-General and his Office should bring the same client service orientation to auditees as is applied to Parliament. This is not, in my view, inconsistent with the Auditor-General's relationship with Parliament (Section V.4 pages 47-48).

2. Fees

Fees for performance audits should be funded by Parliament and not charged to auditees. The negative consequences to relationships of the current arrangements are having seriously adverse effects on the effectiveness of the performance auditing function.

Fees for financial audits should be charged to all auditees. Year-to-year fee charges and fee overruns should be negotiated with auditees in a way which reflects that auditees should only bear the costs for which they are responsible (Section V.4 pages 48-50).

3. Timing of Reports

Auditees should be advised formally and in writing of significant issues as soon as practicable after the issues arise (Section V.4 pages 50-51).

IX. Office Management

In general, the practices of the Office in matters of management of resources, professional training and development and use of information technology are sound and are comparable to those employed by private sector audit firms of similar size. particular, senior management of the Office has taken a proactive role in ensuring that the proper strategic planning and development processes are in place to ensure that Office structure and support evolves consistently with needs, rather than on an ad-hoc basis.

Specific issues which I believe require consideration are:

1. The interests of the Office, staff and auditees would be better served by a restructuring of the Divisional structure below Director of Audit level to a broader pooling of staff than is currently in place (Section V.5 page 52).
2. The Auditor-General would be able to more effectively manage his Office if it was separated from the Public Service and established as a Statutory Authority. However, it is important that the potential consequences of such a change are first evaluated (Section V.5 page 53).
3. The current process of incremental increases each year in the number of staff available for performance audits is appropriate and should be continued (Section V.5 pages 53-54).

X. Overall Conclusion

I have formed the opinion that the Auditor-General is meeting his objectives effectively, economically and efficiently. The direction and momentum of his office is positive and constructive. I hope that the suggestions I have made will assist the Auditor-General further improve accountability, and encourage economic, efficient and effective use of public resources.

Appendix G

Victorian public sector agencies - Audit responsibilities at 30 June 1996

Parliamentary bodies

Parliament of Victoria
Parliamentary Construction Authority

State accounts

Statement of Financial Operations of Victoria

Departments and other independent budget sector agencies

Education, Department of
Human Services, Department of
Infrastructure, Department of
Justice, Department of
Natural Resources and the Environment,
Department of
Ombudsman, Office of the
Police, Office of the Chief Commissioner of
Premier and Cabinet, Department of the
Public Prosecutions, Office of the Director of
Public Service Commissioner, Office of the
Registrar-General, Office of the
Regulator-General, Office of the
State Development, Department of
State Electoral Office
Treasury and Finance, Department of

Public bodies

Adult, Community and Further Education Board,
Office of the
Advanced Dental Technicians Qualifications
Board
Alpine Resorts Commission
Ambulance Officers Training Centre
Andersons Creek Cemetery Trust
Anti-Cancer Council
Architects Registration Board of Victoria
Australian Grand Prix Corporation
Ballarat General Cemeteries and Crematorium
Bendigo Cemeteries Trust
Board of Studies
Brothel Licensing Board
Building Control Commission
Cheltenham Cemeteries Trust
Chiropractors Registration Board
Chiropractors and Osteopaths Registration Board
Construction Industry Long Service Leave Board
(COINVEST)
Council of Adult Education
Country Fire Authority
County Court of Victoria
Crimes Compensation Tribunal

Dental Board of Victoria
Dental Technicians Licensing Committee
Docklands Authority
Eastern Regional Waste Management Group
Emerald Tourist Railway Board
Environment Protection Authority
Estate Agents Council
Estate Agents Disciplinary and Licensing Appeals
Tribunal
Fawkner Crematorium and Memorial Park
Film Victoria
GASCOR
Gas Transmission Corporation
Geelong Cemeteries Trust
Geelong Performing Arts Centre Trust
Generation Victoria
Greyhound Racing Control Board
Guardianship and Administration Board
Harness Racing Board
Historic Building Council
Judicial Studies Board
Keilor Cemeteries Trust
Legal Aid Commission of Victoria
Lilydale Memorial Park and Cemetery
Liquor Licensing Commission
Loddon-Campaspe Regional Planning Authority
Marine Board of Victoria
Medical Practitioners Board
Melbourne and Olympic Parks
Melbourne City Link Authority
Melbourne Exhibition Centre Trust
Melbourne Market Authority
Melbourne Sports and Aquatic Centre
Melbourne Water Corporation
Memorial Park Altona, The
Mental Health Review Board
Metropolitan Fire Brigades Board
Mildura Cemetery Trust
Murray Valley Citrus Marketing Board
Murray Valley Wine Grape Industry Committee
Museum of Victoria, Council of the
National Gallery of Victoria, Council of Trustees
of the
Necropolis Springvale, The
Northern Regional Waste Management Council
Northern Victorian Fresh Tomato Industry
Development Committee
Nurses Board of Victoria
Optometrists Registration Board

Patriotic Funds Council of Victoria
 Penguin Reserve Committee of Management
 Pharmacy Board of Victoria
 Physiotherapists Registration Board
 Plumbers, Gasfitters and Drainers Registration Board
 Police Board of Victoria
 Port of Melbourne Authority
 Powernet Victoria
 Preston Cemetery Trust
 Prince Henry's Institute for Medical Research
 Prothonotary
 Psychosurgery Review Board
 Public Advocate, Office of the
 Public Transport Corporation
 Queen Victoria Women's Centre Trust
 Recycling and Resource Recovery Council
 Registrar of Probates
 Renewable Energy Authority of Victoria
 Road Safety Accident Prevention Trust Account
 Roads Corporation
 Royal Botanic Gardens Board
 Rural Finance Corporation of Victoria
 Sheriff's Office
 Shrine of Remembrance Trustees
 Small Business Development Corporation
 Solicitors' Guarantee Fund
 South Eastern Regional Waste Management Council
 State Electricity Commission of Victoria
 State Film Centre of Victoria Council
 State Library of Victoria, Council of the
 State Swimming Centre Committee of Management
 State Training Board, Office of the
 State Trust Corporation of Victoria
 Supreme Court of Victoria
 Surveyors Board of Victoria
 TABCO Club Keno Business Segment
 TABCO Gaming Business Segment
 Tattersall Club Keno Business Division
 Tattersall Gaming Machine Division
 Tattersall Sweep Consultation
 Templestowe Cemetery Trust
 Totalizator Agency Board
 Tourism Victoria
 Transport Accident Commission
 Treasury Corporation of Victoria
 Urban Land Authority

Victorian Arts Centre Trust
 Victorian Casino and Gaming Authority
 Victorian Conservation Trust
 Victorian Dairy Industry Authority
 Victorian Debt Retirement Fund
 Victorian Dried Fruits Board
 Victorian Financial Institutions Commission
 Victorian Health Promotion Foundation
 Victorian Institute of Forensic Pathology
 Victorian Institute of Marine Sciences
 Victorian Interpreting and Translating Service
 Victorian Meat Authority
 Victorian Plantations Corporation
 Victorian Power Exchange
 Victorian Prison Industries Commission
 Victorian Psychological Council
 Victorian Relief Committee
 Victorian Strawberry Industry Development Committee
 Victorian Tertiary Admissions Centre
 Victorian Workcover Authority
 Waste Management Council
 Water Training Centre
 Werribee Cemetery Trust
 Western Regional Waste Management Group
 Yarra Bend Park Trust
 Zoological Board of Victoria

Universities and other educational institutions

Ballarat, University of
 Box Hill College of TAFE
 Broadmeadows College of TAFE
 Casey College of TAFE
 Central Gippsland College of TAFE
 Deakin University
 East Gippsland Community College of TAFE
 Flagstaff College of TAFE
 Frankston College of TAFE
 Gordon Technical College
 Goulburn Valley Community College of TAFE
 Hawthorn Institute of Education Ltd
 Holmesglen College of TAFE
 John Batman College of TAFE
 La Trobe University
 La Trobe University College of Northern Victoria
 Loddon-Campaspe College of TAFE
 Melbourne, University of
 Melbourne College of Textiles

Monash University
Moorabbin College of TAFE
Northern Metropolitan College of TAFE
Outer Eastern College of TAFE
Royal Melbourne Institute of Technology
South West College of TAFE
Sunraysia College of TAFE
Swinburne University of Technology
Victoria University of Technology
Victorian College of Agriculture and Horticulture Ltd
Victorian College of the Arts
Wangaratta College of TAFE
Western Metropolitan College of TAFE
William Angliss College, The
Wimmera Community College of TAFE
Wodonga College of TAFE

Public hospitals, State-funded nursing homes and ambulance services

Alexandra and District Ambulance Service
Alexandra District Hospital
Ambulance Services Victoria -
 Metropolitan Region
 North Eastern Region
 North Western Region
 South Eastern Region
 South Western Region
 Western Region
Bacchus Marsh and Melton Memorial Hospital
Bairnsdale Regional Health Service
Ballarat Base Hospital
Beechworth Hospital, The
Benalla and District Memorial Hospital
Bendigo Health Care Group
Bethlehem Hospital Inc.
Birregurra and District Community Hospital
Boort District Hospital
Bright District Hospital
Caritas Christi Hospice Ltd
Casterton Memorial Hospital
Clunes District Hospital
Cobram District Hospital
Cohuna District Hospital
Colac District Hospital
Coleraine and District Hospital
Corangamite Regional Hospital Services
Corryong District Hospital
Donald District Hospital

Dunmunkle Health Services
East Grampians Health Service
Eastern Health Care Network
Echuca Regional Health Inc.
Edenhope and District Memorial Hospital
Geelong Hospital
Gippsland Base Hospital
Gippsland Southern Health Service
Goulburn Valley Base Hospital
Grace McKellar Centre
Hamilton Base Hospital
Heathcote District Hospital
Hesse Rural Health Service
Heywood and District Memorial Hospital
Inglewood Hospital
Inglewood and District Health Service
Inner Health Care Network
Kerang and District Hospital
Kilmore and District Hospital
Kyabram and District Memorial Community Hospital
Kyneton District Hospital
Latrobe Regional Hospital
Lorne Community Hospital
Maffra District Hospital
Maldon Hospital
Manangatang and District Hospital
Mansfield District Hospital
Maryborough and District Health Service
Mercy Public Hospitals Inc.
Mildura Base Hospital
Mt Alexander Hospital
Myrtleford District War Memorial Hospital
Nathalia District Hospital
North Eastern Health Care Network
Numurkah and District War Memorial Hospital
O'Connell Family Centre (Grey Sisters) Inc.
Omeo District Hospital
Orbost and District Hospital
Otway Health and Community Services
Ouyen and District Hospital
Penshurst and District Memorial Hospital
Peninsula Health Care Network
Port Fairy Hospital
Portland and District Hospital
Queen Elizabeth Centre
Queen Elizabeth Centre, Ballarat, The
Ripon Peace Memorial Hospital

Rochester and Elmore District Health Service
 Royal Dental Hospital of Melbourne
 Seymour District Memorial Hospital
 Skipton and District Memorial Hospital
 South Gippsland Hospital
 Southern Health Care Network
 St Arnaud District Hospital
 St Vincent's Hospital (Melbourne), Ltd
 Stawell District Hospital
 Swan Hill District Hospital
 Tallangatta Hospital
 Tawonga District General Hospital
 Terang and Mortlake Health Services
 Timboon and District Hospital
 Tweddle Child and Family Health Service
 Wangaratta District Base Hospital
 Waranga Memorial Hospital
 Warracknabeal District Hospital
 Warrnambool and District Base Hospital
 West Gippsland Hospital
 Western Health Care Network
 Western Highlands Health Service
 West Wimmera Health Service
 Wimmera Health Care Group
 Wodonga District Hospital
 Women's and Children Health Care Network
 Wonthaggi and District Hospital
 Wycheproof District Hospital
 Yarram and District Health Services
 Yarrawonga District Hospital
 Yea and District Memorial Hospital

Superannuation funds

Coal Mine Workers' Pension Fund
 Emergency Services Superannuation Board
 Gas and Fuel Corporation Superannuation Fund
 Hospitals Superannuation Board
 Legal Aid Commission Staff Superannuation Fund
 Local Authorities Superannuation Board
 Melbourne Water Corporation Employees' Superannuation Fund
 Parliamentary Contributory Superannuation Fund
 Port of Geelong Superannuation Fund
 State Superannuation Fund
 Victorian Electricity Industry Superannuation Fund
 Victorian Superannuation Board
 Victorian Superannuation Fund

Zoological Board of Victoria Superannuation Fund

Companies, trusts and joint ventures

Albury Gas Company Ltd
 Aluminium Smelters of Victoria Pty Ltd
 Alufin Pty Ltd
 Aluvic Castings Pty Ltd
 Aluvic Services Pty Ltd
 Australian Food Industry Science Centre
 Australian Music Examinations Board (Vic.) Ltd
 Blackspots Projects Trust Account
 Circular Force Pty Ltd
 Citytech Pty Ltd
 City West Water Ltd
 CityWide Service Solutions Pty Ltd
 Daratech Pty Ltd
 Deakin University Foundation Ltd
 Deakin University Foundation Trust
 Dynosis Pty Ltd
 Driver Education Centre of Australia
 Ecogen Pty Ltd
 Energy Brix Australia Corporation
 Energy Business Centre Pty Ltd
 Everton Dell Pty Ltd
 GFE Resources Ltd
 Graduate School of Management Foundation Ltd
 Graduate School of Management Ltd
 Hazelwood Power Corporation Ltd
 Health Computing Services Ltd
 Holding Trust, The
 Institute of Innovation and Enterprise Ltd
 Japlin Pty Ltd
 La Trobe Marketing Pty Ltd
 La Trobe University Housing Ltd
 Loy Yang Power Ltd
 Loy Yang B Power Station Pty Ltd
 Melbourne Business School Ltd
 Melbourne Parks and Waterways
 Melbourne Wholesale Fish Market Pty Ltd
 Meltech Services Pty Ltd
 Milake Pty Ltd
 Mines and Industries Ballarat Ltd, The School of
 Monash International Pty Ltd
 Monash IVF Pathology Services Pty Ltd
 Monash IVF Pathology Services Trust
 Monash IVF Pty Ltd
 Monash Language Centre
 Monash Merchandising Company Pty Ltd

Monash Merchandising Unit Trust
Monash Mt Eliza Graduate School Ltd
Monash Ultra Sound Pty Ltd
Monash Ultra Sound Trust
Monash University Foundation
Monash-ANZ Centre for International Briefing Pty Ltd
Montech Pty Ltd
Mycell International Pty Ltd
National Academy of Music Ltd
National Electricity Pty Ltd
National Power Pty Ltd
Neurometric Systems Pty Ltd
Opalwood Pty Ltd
Open Learning Agency of Australia Pty Ltd
Overseas Projects Corporation of Victoria Ltd
Parkhurst Gem Pty Ltd
Pelletray Pty Ltd
Powernet Victoria
PowerWorks Pty Ltd
Prahan Market Pty Ltd
Qualitative Solutions and Research Pty Ltd
Queen Victoria Market Pty Ltd
Radius Computing Pty Ltd
Rehab. Holdings Ltd
RMIT Foundation
RMIT International Pty Ltd
RMIT Ltd
RMIT Malaysia
RMIT Student Union
RMIT Training
School of Forestry Creswick Ltd
Securities Finance Corporation Ltd
Sir John Monash Business Centre Pty Ltd
South East Water Ltd
Southern Hydro Ltd
Southgate Control Ltd
Southgate Hotel Management Pty Ltd
Southgate Trust
S.T.L. Financial Services Pty Ltd
Swinburne Ltd
TAC Property Investments Pty Ltd
Technisearch Pty Ltd
Telematics Course Development Fund Trust
The Holding Trust
Tiber Pines Pty Ltd
Tricontinental Australia Ltd
Tricontinental Corporation Ltd

Tricontinental Holdings Ltd
Twin Waters Resorts Pty Ltd
Unilink Ltd
Unimelb Ltd
Vicfleet Pty Ltd
Victorian Education Foundation
Victorian Education Foundation Pty Ltd
Victorian Electricity Industry Superannuation Pty Ltd
Victorian Funds Management Corporation
Victorian Institute of Sport Ltd
Victorian Institute of Sport Trust
Victorian Rehab. Centre Pty Ltd
Victorian University of Technology Foundation Ltd
Victorian Medical Consortium Pty Ltd
Western Institute Foundation Ltd
Western Melbourne Business Development Pty Ltd
Yarra Valley Water Ltd

Water authorities

Alberton River Improvement Trust, Shire of
Avoca River Improvement Trust
Barwon Region Water Authority
Broken River Management Board
Bullock Creek Improvement Trust
Central Gippsland Region Water Authority
Central Highlands Region Water Authority
Colac Region Water Authority
Coliban Region Water Authority
East Gippsland Region Water Authority
East Gippsland River Management Board
First Mildura Irrigation Trust
Glenelg Region Water Authority
Glenelg River Improvement Trust
Goulburn-Murray Rural Water Authority
Goulburn Valley Region Water Authority
Grampians Region Water Authority
Kiewa-Murray Region Water Authority
Korumburra River Improvement Trust, Shire of
Lake Wellington Rivers Authority
Lower Goulburn Waterway Management Authority
Lower Murray Region Water Authority
Mid-Goulburn Regional Water Board
Mitchell River Management Board
Ovens Region Water Authority
Ovens River Management Board
Pental Island River Management Board

Portland Coast Region Water Authority
Snowy River Improvement Trust
South Gippsland Region Water Authority
South West Water Authority
Sunraysia Rural Water Authority
Tambo Nicholson River Management Board
Tarwin River Management Board
Upper Goulburn Waterways Authority
Upper North East River Management Authority
Westernport Water Board
Western Region Water Authority
Wimmera-Mallee Rural Water Authority

Municipal councils

Alpine Shire Council
Ararat Rural City Council
Ballarat City Council
Banyule City Council
Bass Coast Shire Council
Baw Baw Shire Council
Bayside City Council
Boroondara City Council
Brimbank City Council
Buloke Shire Council
Campaspe Shire Council
Cardinia Shire Council
Casey City Council
Central Goldfields Shire Council
Colac-Otway Shire Council
Corangamite Shire Council
Darebin City Council
DeLATite Shire Council
East Gippsland Shire Council
Frankston City Council
Gannawara Shire Council
Glen Eira City Council
Glenelg Shire Council
Golden Plains Shire Council
Greater Bendigo City Council
Greater Dandenong City Council
Greater Geelong City Council
Greater Shepparton City Council
Hepburn Shire Council
Hindmarsh Shire Council
Hobsons Bay City Council
Horsham Rural City Council
Hume City Council
Indigo Shire Council
Kingston City Council

Knox City Council
La Trobe Shire Council
Loddon Shire Council
Macedon Ranges Shire Council
Manningham City Council
Maribyrnong City Council
Maroondah City Council
Melbourne City Council
Melton Shire Council
Mildura Rural City Council
Mitchell Shire Council
Moirā Shire Council
Monash City Council
Moonee Valley City Council
Moorabool Shire Council
Moreland City Council
Mornington Peninsula Shire Council
Mount Alexander Shire Council
Moyne Shire Council
Murrindindi Shire Council
Nillumbik Shire Council
Northern Grampians Shire Council
Port Phillip City Council
Pyrenees Shire Council
Queenscliffe, Borough of
South Gippsland Shire Council
Southern Grampians Shire Council
Stonnington City Council
Strathbogie Shire Council
Surf Coast Shire Council
Swan Hill Rural City Council
Towong Shire Council
Wangaratta Rural City Council
Warrnambool City Council
Wellington Shire Council
West Wimmera Shire Council
Whitehorse City Council
Whittlesea City Council
Wodonga Rural City Council
Wyndham City Council
Yarra City Council
Yarra Ranges Shire Council
Yarriambiack Shire Council

Libraries

- Coramgamite Regional Library Corp.
- Eastern Regional Library
- Glenelg Regional Library Corp.
- Hume-Moonee Valley Regional Library Corp.
- North Central Goldfields Regional Library Corp.
- West Gippsland Regional Library Corp.
- Whitehorse Manningham Regional Library Corp.
- Wimmera Regional Library Corp.
- Yarra/Melbourne Regional Library Corp.
- Yarra Plenty Regional Library Corp.

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Part 5.2

Response to Discussion Paper by the Auditor-General of Victoria

OVERVIEW

My overriding reaction to the Review Committee's discussion paper is that if the outcome of the review is based on the thrust of the issues addressed in the paper, the Government's accountability to the Parliament would be seriously compromised.

The key issues, as far as I am concerned, are that an Auditor-General, as Parliament's exclusive auditor:

- must have total discretion in relation to the provision of all audit services to the Parliament, including how they are resourced; and
- cannot be a servant of, or be directed by Executive Government and its agencies

After considering the matters addressed in the paper, I am more convinced than ever that, as I outlined in my January 1997 submission to the Review of the Audit Act 1994:

"There can be no case for any action which focuses on the convenience of the Executive Government and public sector managers and dilutes the value of the distinctive strengths of the existing independence and total discretion of the Auditor-General in providing external audit services to the Parliament and the community".

Objective of the Act

Accurately clarifying the legislative objective is pivotal in discussions concerning competition principles and, in particular, in identifying the nature of restrictions on competition and their justification or otherwise.

The legislative objective contained in the Act is to establish the Auditor-General as the sole independent external auditor, on behalf of the Parliament and in turn the community, of the Government and accordingly of all Victorian public sector agencies. In the discussion paper, the Committee ignores contemporary parliamentary thinking, dismisses the long standing legislative objective and replaces it with one of its own. It is surprising that the Committee has not sought any feedback apparently in the assumption that its objective is more appropriate.

The Committee's objective ignores the fact that the Victorian community are the owners (shareholders) of public sector resources and that Executive Government (authorities and their responsible Ministers), as the delegated manager of these resources, is accountable via the Parliament to the community for the use of such resources.

Independence of the Auditor-General relies on total discretion

The one emerging view signalled by the Committee in its paper on which it seeks external feedback is that the independence of the Auditor-General is not necessarily inconsistent with the more extensive use of competition. However, the Committee fails to provide any substantive arguments for this emerging view.

A fundamental principle which has been completely disregarded by the Committee is that without total discretion on all audit matters external auditors cannot be independent, that is, independence and total discretion cannot be mutually exclusive.

If Auditors-General do not have total discretion over audit resourcing strategies, it follows that they cannot be held accountable for the audit outcomes and for the efficient and effective operations of their Offices.

My resourcing strategies have for many years provided for substantial private sector participation to assist in the delivery of public sector external audit services following a rigorous competitive tendering process. These strategies were initiated at my discretion and have resulted in very co-operative and mutually beneficial relationships with the many diverse segments of the private sector. It is extremely disappointing that the Committee has not referred to my overall resourcing strategies to enable informed discussion by interested parties.

Who is the real client?

The Committee places great emphasis in the paper on its assertion that Ministers and their authorities are clearly clients of the Auditor-General.

The Committee fails to appreciate that there is an essential difference between providing an external audit service to the Parliament, as the Auditor-General does, and the position relating to other interested parties (the authorities and their responsible Ministers) who, as the subject of audit, use the results of the audit service. An Auditor-General cannot be a servant of the Executive Government.

The Committee has also failed to understand that the Parliament is the sole purchaser of external audit services in the public sector and the Auditor-General is the sole provider of such services to the Parliament. It is therefore farcical to suggest that authorities who are the delegated managers of public sector resources should be able to choose their own auditor.

My experience over the last 8 years has led me to conclude that one would have to be extremely naive to believe that Ministers and agencies, and the Parliament have common expectations from the external audit process. In fact, I have experienced considerable frustration over the years in discharging my auditing and reporting responsibilities to the Parliament. There is considerable resistance from the bureaucracy at the prospect of disclosing politically embarrassing findings. Parliament's fundamental right to know is not a principle widely accepted by the bureaucracy which is more motivated by a desire to protect Government and ministerial interests by ensuring potentially sensitive information is not examined and reported to the Parliament.

It is only through an Auditor-General, who is independent and with total discretion, that the Parliament and the community can be assured of receiving complete and reliable information on the Government's management of the community's resources.

In view of the regulatory or whistleblowing element of an Auditor-General's role, to argue for the existence of a client relationship with other than the Parliament could be tantamount to arguing that a client relationship exists between the Victoria Police Force and the law-breakers in the community.

Sole restriction on competition

My January 1997 submission indicated that the exclusivity of the Auditor-General as the Parliament's and the community's external auditor of the Government, as set out in section 1 of the Act, is the sole legislative restriction on competition. It establishes a barrier to entry by another service provider for the provision of all external audit services to the Parliament.

The appointment by the Parliament (on behalf of the community as shareholders) of the Auditor-General as external auditor of the Government and its "subsidiaries", which consist of numerous authorities, equates with the appointment of an external auditor of a public company and its subsidiaries by the company's shareholders. It would be ludicrous to suggest that the external auditor, after appointment by the shareholders, be directed to apply contestability principles to the resourcing of the various elements of the audit including the statutory audit functions. The Committee, in its paper, has advocated just that.

Quality of audit

Because the paper includes a number of unsubstantiated inferences concerning my Office and the expertise of its staff, I feel it is necessary to emphasise that the Office has been at the forefront of proactive change for many years and its reputation, both nationally and internationally, as a leading public sector auditing body can be directly attributable to the skills, dedication and commitment of my staff.

Alternative models?

The Committee lists 3 models which it states are the basic alternatives it has been asked to consider.

Model 1 purports to be the current approach in Victoria which is based on the Auditor-General, as Parliament's external auditor, operating as a single independent audit and reporting voice across the entire public sector, and having total discretion to audit and investigate wherever and in whatever way deemed necessary.

Model 2 envisages mandatory contestability of all audits. The Committee suggests that approaches followed in New Zealand and the Northern Territory fit within this model. Such is not the case as the legislative framework in place in those 2 jurisdictions directly mirrors that in Victoria and, for that matter, all other countries operating under the Westminster system of government.

The New Zealand, Northern Territory and Victorian Auditors-General have introduced, as part of their discretionary powers, varying approaches to contestability in their resourcing strategies. The extent of the benefit which accrues to the Parliament and community from the strategies implemented in Victoria, as evidenced from the breadth of public reporting by the Auditor-General, clearly illustrates the effectiveness of the resourcing strategies adopted for financial and performance auditing in Victoria.

Model 3 would transfer control of the external audit function from the Parliament to the Government and its agencies, and should be dismissed as it is not worthy of consideration.

I fear that models 2 and 3 canvassed by the Committee have the potential to seriously limit the capacity of future Parliaments to monitor the operations of an Executive Government.

Blind adherence to economic dogma which leads to an Executive Government having the power to direct how an Auditor-General may or may not discharge his/her responsibilities, and which removes all discretionary audit powers or allows an Executive Government to by-pass independent scrutiny would seriously weaken the Westminster system of Government. It could also lead to a situation in which a future Parliament, if confronted by an oppressive and corrupt government, would be relatively impotent and not privy to information which would allow it to call such government to account.

I am disappointed that the discussion paper does not cover all the terms of reference. An evaluation by the Committee of the benefits and costs associated with any alleged restriction on competition would have been extremely helpful in responding to the paper, particularly as the Committee acknowledges that assessing the benefits and costs is a crucial element of the Competition Principles Agreement.

Finally, based on the contents of the paper, I consider the Committee has not yet addressed what surely is the most significant element of its review, namely competition and its implications from the viewpoint of the Parliament.

Objective of the Act.....456
Who is the real client?458
Sole restriction on competition.....460
Independence of the Auditor-General relies on total discretion .461
Quality of audit463
Alternative models?465

OBJECTIVE OF THE ACT

Accurately clarifying the legislative objective is pivotal in discussions concerning competition principles and, in particular in identifying the nature of any restrictions on competition and their justification or otherwise.

In my January 1997 submission to the Committee, it was stated that the *Audit Act* 1994 has one objective which is set out in section 1 in the following terms:

“The purpose of this Act is to provide for the office of the Auditor-General and the audit of public accounts”.

This legislative objective establishes the Auditor-General as the sole independent external auditor, on behalf of the Parliament and in turn the community, of the Government and accordingly of all Victorian public sector agencies.

In establishing the Auditor-General as its external auditor, Parliament assigned a key role to the Auditor-General in the State’s public accountability process. It also reinforced the special relationship of the Auditor-General with the Parliament through the following provisions within the legislation:

- a specific requirement that the Auditor-General can only be removed from office with a resolution of both Houses of Parliament; and
- a direct reporting relationship with the Parliament through the Speaker and the President, in contrast with the position of most statutory officers who report to their Minister, who in turn reports to the Parliament.

Simply put, the objective of the Parliament is to have its own exclusive external auditor to scrutinise the operations of the Government and its agencies.

It is important to recognise that the Act has been reviewed on a number of occasions, most recently in 1990 and 1994 and Parliament has, on each occasion, confirmed that the objective of the legislation is appropriate. This objective is consistent with that governing all Auditors-General under the Westminster system of democratic government.

In the discussion paper, the Committee quickly dismisses the longstanding parliamentary view of the legislative objective, and replaces it with one of its own, which could be described, at best, as grammatically confusing and, at worst, as nonsensical. In particular, the Committee’s objective, if read literally, elevates the client status of authorities and their responsible Ministers (that is, the Executive Government) to the ridiculous point where Parliament itself, and not the Auditor-General, is the provider of external audit services to government.

Presumably, the Committee holds the view that the Auditor-General is the service provider to authorities and their responsible Ministers. This view is falsely based as Parliament is the ultimate and in fact the only client of the Auditor-General. There is an essential difference between providing an external audit service to the Parliament, as the Auditor-General does, and the position relating to other interested parties (the authorities and their responsible Ministers) who as the subject of audit use the results of the audit service.

An Auditor-General cannot be a servant of the Executive Government.

The Committee's objective ignores the fact that the Victorian community (the State's shareholders) are the owners of the public sector resources and that the Executive Government (authorities and their responsible Ministers) as the delegated managers of these resources are accountable via the Parliament to the shareholders for the use of such resources.

I am surprised that feedback has not been sought on the objective postulated by the Committee. Many of the key issues discussed in the paper (such as restrictions on competition, the clients of the Auditor-General and independence) are based on the Committee's objective which although derived from a false premise is apparently assumed for the purpose of the paper to be beyond question and carved in stone.

Further, the paper highlights the importance of the 2-part test which must be satisfied to sanction legislative restrictions on competition, namely:

- the benefits of the restriction to the community as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

Surprisingly, the application of the test to the Act is not addressed in the paper. Yet, the Committee uses its objective to identify a range of alleged restrictions on competition and infers that this objective can be met by removing these alleged restrictions on competition.

It would be inconceivable if the Committee proceeded to conclude, based on a false view of the objective, that the second condition of the test had not been satisfied and therefore it was not necessary to evaluate the benefits to the Parliament and the community of the Auditor-General as their sole external auditor.

WHO IS THE REAL CLIENT?

In the paper, the Committee drawing on various input concludes that Ministers and their authorities are **clearly** clients of the Auditor-General and not merely conduits for audit reports from the Auditor-General to the Parliament. The Committee's emerging view is that the Parliament and the citizens of Victoria are the primary clients of the Auditor-General. It also suggests the Government is a client.

The Committee maintains that the above conclusion is consistent with that of the Joint Committee of Public Accounts referring to Joint Committee of Public Accounts Report 346 "Guarding the Independence of the Auditor-General". The Committee has quoted selectively in the paper (p.25) from the Joint Committee of Public Accounts Report 346 as follows:

"Of course, the Auditor-General does not have a single client. The Auditor-General works for the public - providing a window on the operations of government agencies; the Auditor-General also works for Ministers - providing independent advice that assists them to control their portfolio agencies; the Auditor-General works for departments and agencies - providing auditing services and management consultancy advice ... Nonetheless, the Committee believes that the Auditor-General's ultimate client is the Parliament".

Whether by accident or design the last sentence of the material referenced has been omitted from the paper. In the context of any discussion on the Auditor-General's client base the sentence concerned (quoted hereunder) is, in my opinion, a significant omission. According to the Joint Committee of Public Accounts:

"The primary purpose of public audit is to assist the Parliament to hold the Executive to account for its use of public monies".

The Committee has tentatively concluded for the purpose of the paper (p.24) that the over-arching objective of the Act is to:

"Enable Parliament as the Auditor-General's principal client to assure itself of the appropriate (legal, efficient, effective) use of public funds and other resources, whilst providing an external audit service to authorities and their responsible Ministers"

and that it intends to proceed to examine the remaining terms of reference with this objective in mind.

In serving the Parliament and providing information to enable Parliament on behalf of the community to hold the Executive Government to account for its use of public monies, I have found it necessary on several occasions in the past to advise Parliament that in the expenditure of public monies the Executive Government of the day had acted illegally.

The most significant case in recent years involved expenditure of \$35 million, made from the Consolidated Fund in 1989-90 without parliamentary authority, to meet outstanding finance charges on State debt. This arrangement was facilitated through the improper netting-off against appropriations of proceeds received under a financing arrangement involving an interest swap transaction.

Following an inquiry into these transactions, in March 1991, the Parliament's Economic and Budget Review Committee (EBRC) confirmed the assessment of this Office regarding the illegality of the transactions and recommended that action be taken as soon as possible to introduce legislation which validates the unauthorised expenditure. Subsequently, this expenditure was validated by the Parliament through the enactment of a specific purpose provision incorporated in the *Financial Management Act 1994*.

The Chairperson of the EBRC, the Hon. Theo Theophanous MLC, in the Committee's Report to the Parliament acknowledged that "... *the work of the Auditor-General and his officers in highlighting the issues was crucial and led to the Public Account Sub-committee's investigation*".

The above example vividly illustrates that in carrying out audits and providing information to Parliament to enable it to hold an Executive Government to account, an Auditor-General exercises a regulatory role which is inconsistent with the suggested client relationship envisaged by the Committee between an Auditor-General, the Government, Ministers and agencies.

My experience over the last 8 years has led me to conclude that one would have to be extremely naive to believe that Ministers and agencies and the Parliament have common expectations from the audit process. In fact, I have experienced considerable frustration in discharging my reporting responsibilities to the Parliament. There is considerable resistance from the bureaucracy at the prospect of disclosure of politically embarrassing findings. Parliament's fundamental right to know is not a principle widely accepted by the bureaucracy which is more motivated by a desire to protect Government and ministerial interests by ensuring potentially sensitive information is **not examined and reported** to the Parliament.

While I concede that Ministers, government agencies and other interested parties have, and should derive benefit from the audit process, such benefit is merely a by-product of the primary purpose of the audit which to re-iterate the comments of the Joint Committee of Public Accounts is "to assist the Parliament to hold the Executive to account for its use of public monies".

In view of the regulatory or whistleblowing element of an Auditor-General's role, to argue for the existence of a client relationship with other than the Parliament could, in instances such as the illegal expenditure of \$35 million referred to above, be tantamount to arguing that a client relationship exists between the Victoria Police Force and the law-breakers in the community.

SOLE RESTRICTION ON COMPETITION

In my submission of January 1997, I indicated that the exclusivity of the Auditor-General as the Parliament's and the community's external auditor of the Government, as set out in section 1 of the Act, is the sole legislative restriction on competition. This restriction establishes a barrier to entry by another service provider for the provision of all external audit services on behalf of the Parliament.

The appointment by the Parliament (on behalf of the community as shareholders) of the Auditor-General as external auditor of the Government and its "subsidiaries", which consist of numerous authorities, equates with the appointment of an external auditor of a public company and its subsidiaries by the shareholders. It would be ludicrous to suggest that the external auditor of a public company, after appointment by the company's shareholders, **be directed** by management to apply contestability principles to the resourcing of the various elements of the audit including the statutory audit functions. It would be just as ludicrous for the Auditor-General, following appointment by Parliament as external auditor, to **be directed** by Government to open up statutory audit functions, that is, the financial and performance audit of government and its subsidiaries to contestability.

The Committee, in its paper, advocates just that. It regards Parliament's exclusive appointment of the Auditor-General as an action which inappropriately removes the choice of auditor from authorities. The Committee infers that the absence of such choice needs to be addressed but, in doing so, ignores the distinct strengths and benefits which flow to the community from the exclusive appointment of the Auditor-General. Not surprisingly, 2 of the alternative models put forward by the Committee provide authorities with the capacity to appoint their own auditor.

In addition, in discussing its views on restrictions on competition, the Committee has avoided a key term of reference to evaluate the significance of the restrictions in terms of lessening of competition. It is my view that it is premature to consider alternative models before determining whether there is a substantial lessening of competition as a result of alleged restrictions. My January 1997 submission to the review assessed the significance of the legislative restriction and concluded that it had a minuscule impact on the economy in general.

The insignificance of the impact on competition of the legislative restriction is further illustrated by the fact that fees for audit and other services paid to a private sector accounting firm by just one major public company (News Corporation Limited) almost equate to the cost of operating the Office, excluding payments to private sector audit contractors.

INDEPENDENCE OF THE AUDITOR-GENERAL RELIES ON TOTAL DISCRETION

The one emerging view signalled by the Committee in its paper on which it seeks external feedback is that the independence of the Auditor-General is not necessarily inconsistent with the more extensive use of competition. Nowhere in the paper does the Committee provide any substantive arguments for this emerging view.

As pointed out in my January 1997 submission, the Auditor-General, like any auditor in the private sector, must once appointed have total discretion on all audit matters (including resourcing strategies). Such discretion constitutes a principle which is fundamental to the preservation of the independence and credibility of external auditors. This principle applies equally to both private and public sector external auditors and is embodied in professional pronouncements issued by the accounting bodies within Australia and throughout the world (the Act requires the Auditor-General to adhere to Australian Auditing Standards). The principle emphasises that without total discretion on all audit matters, external auditors cannot be independent, that is, independence and total discretion cannot be mutually exclusive.

The application of the above principle does not preclude external auditors from utilising competitive factors in the exercise of their audit discretion. In Victoria, the resourcing strategies have for many years provided for substantial private sector participation to assist in the delivery of public sector external audit services following a rigorous competitive tendering process. These strategies were initiated at the total discretion of the Auditor-General and have resulted in very co-operative and mutually beneficial relationships with the many diverse segments of the private sector.

There are several references in the discussion paper which suggest that the Auditor-General is both a purchaser and provider of audit services and as a consequence the auditing and reporting functions of the Auditor-General can be separated. The paper confuses these issues and fails to understand that the Parliament is the sole purchaser of external audit services in the public sector and the Auditor-General is the sole provider of such services (covering both audit and reporting functions) to the Parliament, i.e. there is one purchaser, the Parliament, and one provider, the Auditor-General.

The key issue is that the Auditor-General must have total discretion in relation to provision of all audit services to the Parliament, including how they are resourced. The importance of total discretion is reinforced by the Australian Government within draft audit legislation (post-Hilmer) currently before the Parliament, which states that:

“... the Auditor-General has complete discretion in the performance or exercise of his or her functions or powers. In particular, the Auditor-General is not subject to direction from anyone in relation to:

- (a) whether or not a particular audit is to be conducted; or*
- (b) the way in which a particular audit is to be conducted; or*
- (c) the priority to be given to any particular matter”.*

The draft audit legislation, which was not referred to in the discussion paper, reflects the contemporary parliamentary view on the subject of independence of Auditors-General. This view was unanimously reaffirmed at the meeting of Federal and State Public Accounts Committees in Sydney as recently as February 1997.

QUALITY OF AUDIT

The Committee has taken upon itself, despite a statement that it does not intend to do so, to review the operations of the Auditor-General. The comments included in the discussion paper are largely based on anecdotal information provided by a small number of authorities. The Committee apparently has not sought the views of Parliament, which is the ultimate and only client of the Auditor-General. Despite the positive and complimentary conclusions reached by the 2 performance audits of my Office, the paper overemphasises minor deficiencies all of which have been addressed. The most recent performance audit in September 1995 found that my Office compared favourably with the "Big 6" chartered accounting firms in respect of financial audits, and with equivalent overseas audit offices in regard to performance audits.

A reading of the discussion paper could lead one to conclude that a financial audit undertaken by my Office is the same as a financial audit carried out in the private sector. In other words, the paper fails to identify that financial audits carried out by my Office extend beyond the forming of audit opinions on financial statements of individual agencies and the whole of government to the examination of a wide range of issues emanating from these audits from a public interest perspective. The results of this examination form the basis of detailed reporting to the Parliament in my annual reports on the Government's financial position and performance and on operations in individual Ministerial Portfolios. This detailed public reporting on the outcomes of my Office's financial audits contrasts sharply with the issue of internal management letters on procedural issues.

The discussion paper refers to a quote from Mr Talbot's 1995 performance audit report on the operations of my Office that "... it would continue to be important for the Auditor-General to audit at least the central agencies which are key to the management of public sector risk [echoing the comments of Fergus Ryan] and to retain some practical auditing experience". Importantly, the discussion paper has omitted to state that Mr Talbot went on to recommend in his report "... retention of certain strategic audits within each industry to enable the Office to maintain an involvement with the issues facing various industry segments, and to control the agents".

The Committee infers in its paper that performance audits undertaken by my Office can be equated with management consultancies (or reviews) carried out by private sector firms. Nothing could be further from the truth.

By way of illustration, consultants work within specific terms of reference set by management (usually involving a problem or a perceived problem identified by management), report the results internally to management, and are often required to assist in the implementation of change as a result of their findings.

In direct contrast, the objectives and scope of performance audits are determined by my Office, independent of management. The audits are aimed at assessing management's performance and determining whether resources have been utilised in an economic, efficient and effective manner. All audit findings, which must be fully substantiated by unassailable audit evidence, are reported to the Parliament and community.

Because the paper includes a number of unsubstantiated inferences concerning my Office and the expertise of its staff, I feel it is necessary to emphasise that the Office has been at the forefront of proactive change for many years and its reputation, both nationally and internationally, as a leading public sector auditing body can be directly attributable to the skills, dedication and commitment of my staff.

ALTERNATIVE MODELS?

The Committee lists 3 models which it states are the basic alternatives it has been asked to consider.

Model 1 purports to be the current approach in Victoria. The Committee does not refer to the fact that under the model the Auditor-General has total discretion in the provision of audit services (including the resourcing of audits) to the Parliament and is subject to a direct line of accountability back to the Parliament through triennial performance audits which assess the economy, efficiency and effectiveness of the Auditor-General's operations.

The Committee suggests that as Auditors-General determine to contract out audit work, a number of questions are provoked. It appears that the Committee fails to appreciate that the questions it has cited are matters solely for the Auditor-General, as Parliament's external auditor, providing a single independent audit and reporting voice to the Parliament and the community, and having total discretion to audit and investigate wherever and in whatever way deemed necessary.

My January 1997 submission detailed the audit resourcing strategies adopted in Victoria in exercising total audit discretion assigned by the Parliament. It is extremely disappointing that the Committee has not referred to these resourcing strategies (which are summarised below) to enable informed discussion by interested parties.

Model 2 envisages mandatory contestability of audits. It removes discretionary powers on resourcing of audits (such as the mix of inhouse and external resources) from the Auditor-General with audit resourcing solely an outworking of a tendering process. Our research indicates the model does not exist in any country operating under the Westminster system of Government.

The Committee suggests that approaches followed in New Zealand and the Northern Territory fit within this model. Such is not the case as the legislative framework in place in the 2 jurisdictions directly mirrors that in Victoria and the respective Auditors-General have, in using their discretionary powers, adopted different resourcing strategies to those in Victoria, primarily because of local circumstances. The discussion paper indicates that the New Zealand Auditor-General puts all audits, other than performance audits, out to tender. This statement is also incorrect. As indicated in the Auditor-General's submission, at 30 June 1996, the New Zealand Auditor-General, in exercising his discretionary powers had determined that around 80 per cent (or 666) of financial audits, other than audits in the education sector, would be undertaken inhouse and not subject to contestability.

Apart from the very serious issue of impairing audit independence through removal of discretionary powers, any enshrining of prescriptive strategies within legislation could lead to a ludicrous situation where an Auditor-General could not undertake statutory audit functions on behalf of the Parliament because of the unavailability of suitable resources.

In discussing the New Zealand approach, the Committee has identified that audit costs have fallen and the quality of services had improved, from the viewpoint of the authorities audited. However, the Committee has failed to compare the existing position regarding audit costs and quality of services in Victoria with that which prevailed in New Zealand prior to adoption of the current approach. In other words, it has not addressed how relevant any audit trends in the New Zealand scene are to Victoria.

Model 3 is totally inconsistent with the objective of the Audit Act. It would transfer control of the external audit function from the Parliament and the community as the owners of public resources to Government and its agencies who are accountable to the owners. It should be swiftly dismissed as it is not worthy of consideration.

An independent Auditor-General and an independent audit office are crucial prerequisites for good governance in the public sector. Any changes to the audit legislation should ensure that Parliament and the community are protected from oppressive and corrupt governments.

Unfortunately, in the blind pursuit of competition, I fear that models 2 and 3 canvassed by the Committee have the potential to seriously limit the capacity of future Parliaments to hold Executive Governments to account for their management of public resources.

Outline of Office's resourcing strategies

Financial auditing

Financial auditing cover the audit of the Government's consolidated financial statements and the audit of 547 public sector agencies, which includes examinations of compliance with legislation and government regulation.

For many years, in order to meet specific resourcing needs, including reporting responsibilities to the Parliament utilising in-house expertise, my Office has adopted a strategic approach to the resourcing of financial audits which involves a combination of inhouse and private sector resources. Currently, 75 per cent of the entire financial audit base is serviced by private sector resources at a cost of \$5.8 million which are engaged following a competitive tendering process.

When engaging private sector firms as contractors, the Auditor-General ensures that the independence of the external audit is not called into question because of potential or actual conflicts of interest by precluding the involvement of private sector firms in the provision of non-audit services, a situation, which, if allowed, would contravene the spirit of the Audit Act.

As more services are outsourced in the private sector, the Office is finding it increasingly difficult to identify private sector accounting firms to assist in financial audits who are not currently or have not recently provided services to the Government or agencies subject to audit.

The fundamental objective of the resourcing strategy is to ensure that I, as Auditor-General, maintain the capacity to effectively discharge my mandate by facilitating the accountability of all agencies to the Parliament and examining issues from a public interest perspective.

The Office's financial audit resourcing strategy involves:

- inhouse resourcing of:
 - agencies responsible for policy formulation and the purchase of services (eg. Departments);
 - agencies which interface and impact across government (eg. Treasury Corporation of Victoria);
 - at least one Government-owned service provider in each industry segment;
 - agencies which have significant exposures to taxpayers (eg. Public Transport, State Superannuation, WorkCover etc.); and
- private sector firms conducting the balance of audits, with the Auditor-General retaining responsibility for the provision of audit opinions to ensure that the State's interests are protected and there is proper accountability to the Parliament, a strategy endorsed by Mr A Talbot (in September 1995), the Hon. A. Stockdale (in August 1994) and the Hon. R. Hallam (in May 1995 when the Office was given responsibility for the audit of municipal councils).

To ensure the provision of cost-effective audit services, the audits undertaken utilising in-house resources are benchmarked against audits undertaken by private sector contractors and against audits undertaken by other audit offices across Australia.

As the Auditor-General is responsible to the Parliament for all public sector financial audits, the Office has established, as part of its contract management activities, high level reviews of work conducted by the private sector firms prior to the Auditor-General signing audit opinions and issuing audit reports. Such quality oversight of private sector work has enabled the Office to identify and rectify inconsistencies in financial reporting and accountability across industry segments and government. This process also ensures that:

- contractors maintain appropriate quality standards;
- issues which arise from individual audits which impact on other government agencies are addressed; and
- significant and common financial management and accountability issues are brought to the attention of Parliament, Ministers, central agencies and individual agencies.

For the Auditor-General to effectively provide Parliament with sound and comprehensive assessments of key financial issues, it is critical that the Office maintains the above direct and detailed involvement in the audit of key agencies. In particular, the retention of strategic audits enables the Office to:

- gain knowledge of the issues facing the Government and the various industry segments in the management of public sector risk; and
- maintain appropriate skill levels to control the effectiveness of contractors.

The current reports to the Parliament resulting from the financial audit process comprise the annual Report on Ministerial Portfolios and the Report on the Government's Statement of Financial Operations. The success of the current financial audit resourcing strategy is reflected in the importance and diversity of the issues of public interest consistently brought to the Parliament's attention over many years.

The issues reported, stemming from the financial audit process, have included highlighting the deterioration of the Victorian financial position in the early 1990s, the inaccurate and incorrect reporting of transactions, the inefficient use of resources, and the disclosure of major public sector asset sales and financial arrangements of some of the State's largest infrastructure projects.

Performance auditing

All performance audits are conducted by in-house staff with qualifications and practical experience in a range of areas such as program evaluation, social sciences, economics, science and finance. These staff have unique expertise in external performance auditing and reporting, covering resource management issues within a public sector environment, including audits within individual agencies and extending across a range of agencies. There is no equivalent audit function within the private sector culminating in comprehensive public reporting across all facets of resource management.

The Office's expert performance audit staff have been responsible for the breadth and diversity of key issues and related outcomes communicated in the 47 special performance audit reports presented by the Auditor-General to the Parliament since the early 1980s which have focused on various significant and high risk areas of public sector operations.

Subject to consultation with the Public Accounts and Estimates Committee, the Act provides the Auditor-General with total discretion in the selection, timing, scope and resourcing of performance audits by including the provision "... *the Auditor-General may conduct any audit he or she considers necessary*". The Office has placed considerable emphasis on the selection and planning of performance audits in order to:

- focus on the accountability of the Government in key areas of public interest;
- minimise the risk of agencies not achieving value-for-money; and
- maximise the use of available Office resources.

The effective selection and planning of performance audits requires the maintenance of a sound knowledge of developments both within individual portfolios and across Government generally. The strategy of maintaining an in-house resource base with active involvement in the conduct of performance audits is seen by the Office as essential to maintaining this whole-of-government knowledge.

To complement the multi-disciplinary in-house staff, external specialists are engaged to provide specific advice and assistance to the Office to ensure a credible outcome on those audits where skills and knowledge in the subject area are not available and it is not cost-effective for the Office to engage such skills on an ongoing basis. The cost-effective management of specialists participating in performance audits is a prime responsibility of the in-house audit staff.

By way of illustrations, in the performance audit of the Alfred Hospital, the services of a private sector medical practitioner were used to assist in the audit; in relation to the performance audit on the State's Child Protection Services, 2 widely recognised experts in child welfare provided assistance; and in the audit dealing with Marketing Government Services, an expert with in excess of 20 years standing in the fields of advertising and market research was utilised.

In most cases, specialists who assist on performance audits are engaged following a competitive tendering process. The cost of external specialists represents a small component of the Office's outlays on contractors.

The use of external specialists to assist on performance audits will remain an integral part of the Office's performance audit resourcing strategy. The practice of supplementing in-house performance audit resources with external specialists on an as-needed basis is a common practice of Auditors-General within Australia and overseas.

The policy by the Government of outsourcing services will necessitate a greater emphasis on the reporting by agencies of outcomes and outputs. Assessing outcomes and outputs is an area where the Office has gained extensive experience over a number of years in its performance auditing function. The Office holds the view that widespread use of outsourcing by Government reinforces the need for an independent performance auditing function experienced in determining whether reported outcomes and outputs have been achieved.

As with financial auditing, with the outsourcing of services to the private sector it will be increasingly difficult for the Office to identify external specialists, particularly within the major private sector accounting firms, to assist in performance audits who are independent of the Government and the agencies subject to audit.

In relation to the level of the Office's performance audit resources, Mr Talbot, in his 1995 performance audit report on the Office, stated:

"It is my personal view that progressively increasing the resources by 30 per cent a year is practical and desirable".

The Office's performance audit methodology, which is a risk-based value-added approach, was developed exclusively in-house and is specifically aligned to the Auditor-General's legislative mandate for performance audits. The methodology was favourably commented upon by Mr Fergus Ryan, in his 1992 performance audit report on the Office, who stated that:

"The Office's performance audit methodology is advanced in development by world standards" and, in relation to performance auditing reporting, "... the Office is at the leading edge by world standards".

Index

Adult, community and further education, management of grants	45	Melbourne to Warrnambool rail passenger service, contracting out	113
Alpine resorts, reform of	163	Millennium bug, the year 2000 issue	299
Asset holdings and recognition, Department of Natural and the Environment	154	Municipal electricity undertakings, transfer of	93
Audit Act 1994, review of	311	Natural Resources and the Environment	151
Submission by the Auditor-General	313	Parliament of Victoria	13
Response to Discussion Paper by the Auditor-General	449	Petroleum Resources Rent Tax dispute settlement	239
Contaminated land sites	97	Ports, Victorian, reform of	254
Corporate Card	285	Premier and Cabinet	191
Corporate governance in the public sector	273	Private practices arrangements, follow-up	62
Country Fire Authority, implementation of finance system	136	Public sector financial reporting	279
Crown land reserves, management of	157	Public transport revenue protection, patronage levels and automated ticketing system	104
Education	19	Rural Melbourne Institute of Technology, property management at	32
Geelong, divestment of retail development at	99	Schools, financial management in	21
Health Service Agreements, delays in finalising	65	State Development	197
Human Services	59	State Revenue Office, revenue collection	258
Information technology security	303	Treasury and Finance	203
Infrastructure	83	Urban Land Authority, purchase of painting ..	123
Justice	133	Victorian electricity industry privatisation	222
Local Authorities Superannuation Board	209	Water, unaccounted	167
Local government, financial reporting	86	WorkCover, financial standing of, update	213



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