

VICTORIA

Auditor General

Victoria

Results of special reviews and other investigations

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AUDITOR GENERAL
VICTORIA

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President
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Parliament House
MELBOURNE

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Legislative Assembly
Parliament House
MELBOURNE

Dear Presiding Officers

I am pleased to forward this report to you for presentation to each House of Parliament, pursuant to section 16AB of the *Audit Act 1994*.

This report sets out the results of a number of special reviews and other investigations undertaken up to the date of preparation of the report.

Yours faithfully

JW CAMERON
Auditor-General

4 May 2005

Foreword

The conduct of, and reporting on, special reviews and other investigations covering specific aspects of public sector administration and performance has been an important part of our work for many years. The steady increase in requests from parliament, members of the public and statutory officers such as the Ombudsman, for these types of audits has required us to give greater attention to this part of our activities in more recent times.

This report contains the results of 4 recently completed audit investigations and 6 special reviews.

The audit investigations examine a number of significant allegations and concerns conveyed to my office by external parties. They cover:

- the management of a major fire control line construction during the 2003 fire season
- the administration of an industry assistance program
- the financial management practices of a local government council and a cemetery trust.

The 6 special reviews cover:

- a follow up to my October 2002 performance audit report on *Community dental services*
- the qualifications and registration of medical practitioners in Victorian public health services
- the sale of the Overseas Projects Corporation of Victoria Ltd's major assets
- the implementation of 2 major "change" projects, aiming to improve public sector asset management and telecommunication services
- capital budgeting and management by local governments.

The report identifies scope for improvement in each of the areas examined and makes recommendations to strengthen agency practices and performance. While the findings and recommendations are primarily directed towards the specific agencies examined, they also provide useful insights and lessons to be learned for other agencies with similar activities.



JW CAMERON
Auditor-General

4 May 2005

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1. Executive summary



1.1 Introduction

This report sets out the results of 10 special audits which examine:

- the validity of several significant allegations and concerns conveyed by external parties to my office, about the propriety, adequacy and transparency of several agencies' management and administrative practices
- the adequacy of processes for ensuring that medical practitioners employed in Victorian health services are appropriately qualified to practice medicine
- the progress made by the Department of Human Services and Dental Health Services Victoria to address the significant matters raised in my October 2002 performance audit report entitled *Community dental services*
- the adequacy of the process used for (and outcomes achieved from) the sale of the Overseas Corporation of Victoria Ltd's major assets
- the progress made in implementing 2 major "change" initiatives (the Government Infrastructure Management System and the Telecommunications Purchasing and Management Strategy), which aim to improve asset management and telecommunication services across the public sector, respectively
- the quality of capital budgeting and management by local governments.

The major conclusions and recommendations from these audits are presented below.

1.2 Overall conclusions and recommendations

1.2.1 Cheltenham and Regional Cemeteries Trust - Review of expenditure and related matters

The Cheltenham and Regional Cemeteries Trust (the trust) was established in 1865 and manages cemeteries at 3 locations: Cheltenham Memorial Park, Cheltenham Pioneer Cemetery and Bunurong Memorial Park. A voluntary 8-member trust oversees the administration of the cemeteries.

In July 2004, 2 trust members expressed concerns to the Department of Human Services (DHS) about the expenditure of trust funds and related matters at the trust. DHS subsequently referred these matters to my Office for investigation. Given the significance of the matters (which questioned the propriety, transparency and accountability of certain trust activities), the need to examine them in further detail became apparent.

Our investigation concluded that the trust made, and continues to make, substantial expenditures that are excessive by public sector standards and not for the purposes of the trust. Despite continually being made aware of appropriate purchasing practices by DHS and my Office, the trust over several years engaged in practices that are unacceptable for agencies in the public sector.

We further concluded that the entry into, and the ongoing relationship between the trust and 2 companies owned and operated by the sons of the trust's Chief Executive Officer (CEO) were not transparent, fair and contestable and exposed the trust to significant ongoing risks. We found that the trust:

- improperly used trust funds to purchase a vehicle for the CEO's wife's private use
- sold trust assets to staff and related parties without a transparent sales process or a policy to guide such sales
- in relation to its dealings with one contractor, failed to tender for significant work, obtained financial accommodation without gaining the necessary approval, paid contractor's costs it was not required to pay and entered into a lease of crown land that resulted in considerable cost to the state
- guaranteed a private loan for the CEO and his wife without obtaining the necessary approval
- failed to comply with existing purchasing policies on a routine basis
- illegally paid incentives to private businesses
- made substantial expenditures on items that may deliver a private benefit to trust members and staff, without having policies to guide such expenditures
- failed to maintain adequate security over its fixed assets.

Recommendations

Several recommendations were made focusing on the need for the trust to immediately strengthen its governance arrangements, and its expenditure policies and practices. These included a need for the trust to:

- require all substantial financial matters to be considered by a meeting of trustees in advance of commitments being made
- ensure adequate and timely consideration of key management decisions, and compliance with legislative requirements and purchasing policies
- review its tendering policies, practices and processes to ensure that all aspects of all its procurement activities are governed by policies that meet or exceed the standards set by the Victorian Government Purchasing Board
- not approve expenditure or asset purchases that are not directly relevant to the trust's objectives and operations
- engage an independent party to develop and assess options for the future provision of information technology services to the trust, and to make recommendations
- implement rigorous controls over approvals for information technology services in addition to the minimum agreed services
- ensure that the remuneration of its future CEO is in line with government policy on executive remuneration
- immediately bring its asset register up to date.

We also recommended that DHS ensure trust members have appropriate skills and expertise to effectively discharge their responsibilities.

1.2.2 Qualifications and registration of medical practitioners in Victorian public health services

The regulatory framework for the practice of medicine in Australia is complex, with different Commonwealth and state responsibilities.

We assessed the adequacy of procedures and processes established to ensure that medical practitioners employed in Victorian public health services are appropriately qualified to practice medicine. We examined the processes for registration of medical practitioners in Victoria by the Medical Practitioners Board of Victoria (MPBV) and the credentialing and other employment related quality assurance processes used by 4 Victorian hospitals.

We found that the systems used by the MPBV to register medical practitioners are generally consistent with the requirements of the *Medical Practice Act 1994* (the Act). However, of the 8 cases examined, the level of documentation to support the registration of medical practitioners was at times inadequate.

In cases where registration occurred under the specific registration provisions of the Act¹ and where supervised study or training arrangements were required for registration, we further found that the specific detail included in applications, of supervised training and the skills and knowledge needs of applicants, varied considerably. Some applications simply indicated ‘as appropriate to the position’, some attached a copy of a generic training program and others attached detailed plans and rosters to show the number and seniority of staff supervising the medical practitioner.

The MPBV does not require a structured and consistent approach to supervised study or training for specific registration. However, it does take into account the appropriateness of the proposed supervised training, considering the individual needs of the applicant, when making the decision to register an applicant or not.

Finally, we found that the systems and controls used by hospitals to ensure that medical practitioners are appropriately qualified, trained and supervised were better in larger hospitals than in smaller or more remote hospitals. The latter have a smaller pool of medical practitioners from which to recruit and they also are less likely to have well resourced, formal structures to supervise or train medical practitioners.

¹ Section 8(1) of the Act provides for a “specific registration” of an applicant, where the applicant has a primary medical qualification from a university that has not been accredited by the Australian Medical Council and the applicant has not completed the requirements for general or provisional registration.

Recommendations

Several recommendations were made focusing on the need for the MPBV to strengthen its administrative processes and requirements for supervised training under specific registration, and for the Department of Human Services to support these endeavours.

1.2.3 Progress in addressing the recommendations of our performance audit report, *Community dental services*

Our October 2002 performance audit *Community dental services* assessed how well the Department of Human Services (DHS) and Dental Health Services Victoria (DHSV) managed the delivery of community dental services². It identified scope for improvement, and made 15 recommendations addressing 4 main areas:

- service access
- service delivery
- work force management
- program management.

The follow-up audit found that DHS and DHSV had implemented a number of our 2002 recommendations. In particular, they had:

- increased service delivery and implemented a number of initiatives to reduce demand in the longer term
- taken steps to improve efficiency in clinics
- addressed several of the clinical practice and compliance issues in dental clinics.

In particular, DHSV had implemented a number of initiatives to improve and enhance service provision. Progress was also made on a series of plans, starting with the *Oral Health Strategic and Service Plan for Victoria*, developed to provide a comprehensive framework for the dental public health service. However, progress was slow in:

- improving waiting list management practices
- developing agency level information on costs and agency level benchmarks.

² DHS has policy and program responsibility for public dental health in Victoria, while DHSV is the lead agency responsible for coordinating and managing public dental health services.

The increase in government funding for community dental services from 2004-05 (\$97.2 million over 4 years) presents an opportunity to address the worsening access issues identified in our 2002 report. The challenge now is to provide the modelling, long-term framework and plans to deliver measurable improvement in the delivery of dental public health services, and the oral health of Victorians.

Recommendations

Several recommendations were made focusing on the need for:

- **DHS, in collaboration with DHSV, to undertake comprehensive modelling work to better inform the allocation of the additional government funds**
- **DHS to better understand the costs of service delivery and develop a funding formula based on this information**
- **DHS and DHSV to collaborate on the implementation of a waiting list strategy, as a priority**
- **DHSV to complete the work commenced on benchmarking the efficiency of dental clinics, to better inform the development of improvement strategies**
- **the dental capital plan (which DHS and DHSV will jointly develop) to include an analysis of the desired configuration of fixed and mobile clinics, and plans to decommission any dental service vans identified as not meeting clinical standards and service requirements**
- **DHSV to develop a more complete dental health workforce database, to better inform the analysis of current workforce strategies and the development of future strategies**
- **DHS to monitor and report on the effectiveness of implementation of their 2, 5 and 10 year public dental workforce strategies**

1.2.4 Implementation of the Telecommunications Purchasing and Management Strategy (TPAMS)

In July 2002, as part of its *'eGovernment vision - Putting People at the Centre'* initiative, the government launched the Telecommunications Purchasing and Management Strategy (TPAMS). The strategy establishes a framework for the whole-of-government procurement and management of telecommunications services into the future. It involves 4 projects that aim to improve the accessibility, quality and cost of telecommunication services across the Victorian public sector.

Our examination of the implementation of TPAMS concluded that, overall, this initiative was effectively planned and managed. Although minor project delays and project cost revisions were experienced, the project is still on track to meet the June 2006 deadline and is within budget. However, enhancements to project cost and milestone reporting need to be considered.

The program's project governance and management by the Department of Infrastructure and its Chief Technology Office is robust. However, the role of the Office of the Chief Information Officer (within the Department of Premier and Cabinet) needs to be reviewed and clarified in relation to monitoring whole-of-government information technology projects.

The telecommunications contract procurement process was assessed as fair, followed due process and complied with Victorian Government Purchasing Board guidelines.

It is still too early for us to conclude that all TPAMS program expected benefits and cost savings will be achieved. However, early indications are that lower telecommunication prices were negotiated and regional areas may have enhanced telecommunications access. The project team indicated that the original expected savings, of \$73 million over 5 years, are likely to be exceeded.

Although the TPAMS program risks are adequately managed, as the TPAMS program progresses risks associated with government department and agency take-up of telecommunication services and the chief technology office's ability to manage multi-supplier and user telecommunication services, will need to be closely managed.

Recommendations

That the TPAMS governance committee monitor whole-of-project-life costs, and capital and operating expenditure, for each of the TPAMS projects.

That the Office of the Chief Information Officer and other central government agencies interested in whole-of-government IT projects review and clarify their roles and lines of reporting for large IT projects.

That the Chief Technology Office ensures it is able to identify and manage emerging risks as TPAMS projects move into later stages.

1.2.5 Management of Overseas Projects Corporation of Victoria Ltd's major asset sale

The Overseas Projects Corporation of Victoria Ltd was established in 1985 as a state-owned company. Its mission was to export Victorian public and private sector skills (such as project management skills), technologies and equipment to external markets. Most of its work focused on projects conducted in developing countries.

The company experienced considerable financial difficulty over recent years. Advice from its board that it was not a core government business, contributed to the government's decision in October 2003 to sell the company.

In June 2004, the company concluded an asset sale agreement with a private party, for \$1.4 million. This agreement sold the company's interest in most of its ongoing major projects and partnering arrangements, and its trading name. It also transferred almost all of the company's permanent employees to the buyer. The buyer also agreed to manage, on the company's behalf, those projects retained by the company on a fee-for-service basis.

We examined the adequacy of the sale process, the outcomes achieved and the arrangements established for the eventual wind-up of the company and the management of any residual issues.

To achieve a satisfactory sale outcome, it was important for the sale to be completed expeditiously given the nature of the company's business and the importance of ensuring that the skills and experience of its employees were retained during this period. It was equally important that due process, including a high standard of equity, transparency and probity, was maintained throughout. We concluded that, while the sale was conducted expeditiously under difficult circumstances, some procedural matters were deficient.

While acknowledging that there were several strengths in the process adopted for the sale (including comprehensive sale documentation and the engagement of a probity adviser) and that the sale process was made more difficult by the company's considerable financial difficulties, there are lessons to be learned for future asset sales, including:

- key sale documents should be formally approved prior to their issue to the market
- probity plans issued to bidders should be followed
- the conclusions and recommendations of the bidder selection committee should be formally documented and signed-off by its members

- where the nature of a sale changes during the sale process (for example from a sale of a company to a sale of the company's assets), at least all short-listed bidders should be given the same opportunity to submit proposals
- committees established to oversee the conduct and management of the sale of an entity should take a leadership role, not become an integral part of the conduct of the sale and should be independent of the entity's board or management, therefore ensuring the government's ownership interests are protected
- advisers to a sale process, which have an affiliation or interest which might create a possible perception of a conflict of interest, should not participate in the process
- the successful bidder should not be allowed to take over the entity (or the purchased assets) before the sale agreement is finalised.

The cash proceeds of the sale, which were received by the company and totalled \$1.4 million, fell below the company's revised valuation of the projects sold (\$1.5 million) and the original estimated proceeds for the sale of the company as a whole (\$2.5 million). Further, the state continues to bear risks arising from the unsold projects of the company. Nevertheless, based on the 2 offers received, the state achieved the highest available cash return on the sale.

The state has contributed some \$9.9 million as capital to the company since its inception in 1985. In June 2004, the state also provided a grant of \$400 000 to the company to meet some of its debts. In return, the company has contributed dividends totalling some \$800 000 to the state since 1992. At 30 June 2004 (after taking into account the proceeds from the sale), the company's net assets amounted to \$1.3 million, with a further \$317 000 estimated as being needed to complete its wind-up. Clearly, the majority of the state's investment in the company has been lost.

The wind-up of the company's affairs was incomplete at the time of preparing this report and an up-to-date plan (and budget) needs to be prepared and approved for this purpose.

Recommendation

That the board of the Overseas Projects Corporation of Victoria Ltd, together with the liquidator and the Department of Industry, Innovation and Regional Development, prepare a revised plan for winding-up the company's affairs for the approval of the Minister for State and Regional Development.

1.2.6 Implementation of the Government Infrastructure Management System project

The Government Infrastructure Management System (GIMS) project commenced in 2000 with the overall aim to improve asset management across the public sector. This was to be achieved through the implementation of new software, supported by enhanced policies and procedures. The Justice portfolio was chosen to pilot the new software which was to be acquired under the project.

We examined whether this project was adequately defined, implemented and managed by the participating agencies in the Justice portfolio.

While the Department of Justice (DoJ) planned to fully implement the software by January 2003 across a number of its business groups and portfolio agencies (Victoria Police and the Country Fire Authority), at the time of our audit (February 2005), the software was not fully implemented within the DoJ business groups (including Corrections Victoria, Courts and Tribunals, and the Victoria State and Emergency Services).

Our review of the project's management found that better project governance and coordination would have reduced some of the delays encountered.

One of the aims of the GIMS project was to enable cross-agency comparisons, monitoring and benchmarking of asset management performance. This aim has not been achieved by participating agencies, as not all are recording all common assets (such as plant, equipment and buildings). Unless there is greater standardisation of approaches and asset types recorded, this aim (and one of the stated benefits of the project software) will be difficult to achieve.

With the GIMS software now being considered for use by other public sector agencies, it is important that a full post-implementation review of the Justice portfolio GIMS project be conducted. This will ensure that public sector agencies benefit from the lessons learned by Justice portfolio participating agencies.

Recommendations

Several recommendations were made focusing on the need for DoJ to ensure that:

- **project plans and budgets for future major IT projects are formally endorsed by relevant governance bodies or senior staff before the plans are implemented**
- **expenditure on major projects is regularly monitored and reported against project budgets**
- **future IT projects involving multiple business groups within DoJ and/or other agencies have a senior representative (such as a deputy secretary) appointed to their steering committee**
- **all participating agencies and business groups regularly check their GIMS database records against records in their financial systems**
- **a post implementation review of the GIMS project is undertaken.**

1.2.7 Construction of the Yalmy Road fire control line

During February 2003, as part of an effort to extinguish the largest wildfires ever experienced in Victoria, the Department of Sustainability and Environment (DSE) constructed a fire control line along Yalmy Road in East Gippsland. This operation was carried out in extraordinary circumstances, involving a large number of fires that simultaneously burnt over a considerable period of time, spreading rapidly and behaving erratically, and therefore placing considerable time and resourcing pressures on DSE during this time.

After receiving an allegation from a member of the public in early 2004, that timber with a substantial market value was stolen from this fire control line, I decided to investigate the claim and examine how well DSE managed the construction of the control line.

The primary objective of DSE's effort in constructing the fire control line was to limit the impact of the fires on life, property and community assets. Our investigation found that deficiencies in the planning and management of the control line compromised DSE's fire suppression effort. Trees representing a high fire hazard were not removed, while trees representing a low fire hazard, but containing high quality timber, were removed from the control line. Pushing trees and vegetation up against the forest wall also created a fire hazard that threatened the safety of firefighters.

In constructing the control line, DSE failed to comply with a number of legislative requirements and its forestry/fire management codes of practice. The most significant breach involved the taking of wood from the Snowy River National Park for commercial use, which is not permitted under the *National Parks Act 1975*. DSE also failed to properly supervise, accurately record and check the timber salvaged.

An internal investigation into the management of the fire control line, conducted jointly by DSE and Parks Victoria, went to considerable effort to establish a sound basis for sampling forest plots in order to determine the volume of timber taken from the site. However, by not establishing whether logs were removed from the trees that were “pushed over”, it was not possible to determine what timber was taken from the site. Consequently, we were not able to determine whether appropriate royalties were paid to DSE for all timber removed from the control line.

The internal investigation made several recommendations to help improve the management of similar fire suppression efforts in future. While DSE did not publicly release a summary of the investigation report until some 12 months after it was completed, it had taken appropriate action to address its recommendations.

Recommendations

That future investigations be better planned by DSE to ensure that sufficient evidence is gathered to enable as firm as possible conclusions to be drawn from the data available.

That, in future, DSE publicly releases the findings of major investigations dealing with issues of public interest, on a timely basis.

1.2.8 Administration of the contractor assistance program

In 2002, the government announced its aim to reduce the volume of hardwood sawlogs harvested in Victoria's state forests through the buy-back of licences. The contractor assistance program (CAP) was established to assist contractors affected by the buy-back program and exiting the industry. The Department of Sustainability and Environment had overall responsibility for the assistance program.

In 2004, a number of correspondents expressed concerns to my office about the management of CAP, particularly the prioritisation process employed to provide CAP assistance. We investigated those concerns.

We found that the program attracted 175 applicants, many more than originally anticipated. To assist all eligible applicants would have required funding in excess of initial and revised funding estimates. To address this situation, assistance was initially provided to 38 eligible applicants assessed as a high priority in a first round of the program. This exhausted funding available for the program at that time.

A further 119 applications were put on hold until additional funding became available. The initial guidelines did not mention the prioritisation process and therefore contributed to the expectation that all eligible applicants would receive assistance.

While additional funding was subsequently made available, it was insufficient to assist all remaining applicants. Program guidelines and priority criteria were amended that effectively limited eligibility for assistance to applicants from specific areas. Following assessment on this revised basis, 25 of the remaining applicants received assistance. The remainder still interested in receiving assistance were deemed ineligible or advised that their applications would not be considered further.

Our review identified that many of the management processes used in the program were effective. However, we also identified a number of lessons to be considered when developing and implementing future assistance programs. These included ensuring that:

- detailed funding estimates are developed in the initial stages of programs
- potential applicants are fully informed of all aspects of the program, particularly where not all eligible applicants will receive assistance, applications are to be prioritised or provision exists for amending criteria during the assessment process
- decisions on assistance to individual applicants are fully supported by documentation

- realistic deadlines are set for the receipt of applications and supporting information, and policies for late applications are clearly developed and complied with
- processing of applications for assistance and notification of applicants of the outcome of assessment processes is timely.

Recommendations

Several recommendations were made to help strengthen the administration and management of future industry assistance (and similar) programs. These focused on the need for program delivery agencies to ensure effective planning, governance and implementation arrangements are established, and clearly communicated to all stakeholders, so that that program objectives can be best achieved.

1.2.9 Capital budgeting and management by local governments

In each of 2002-03 and 2003-04, Victoria's 79 local governments (councils) spent over \$800 million acquiring and renewing assets (including major infrastructure assets such as roads, bridges and drains) used to deliver services to their local communities. On average, this capital expenditure equated to 20 per cent of their total annual revenues.

Our examination of the capital budgeting and management processes used by 9 councils concluded that these authorities were not currently managing their capital expenditure programs as well as they could.

The councils examined failed to achieve their budgeted annual capital programs over the past 2 years. This experience reflects the broader experience of the local government sector.

All but one had yet to implement a comprehensive asset management framework, covering all classes of major assets, that allow them to plan their capital expenditure "top down", both strategically and operationally. The Municipal Association of Victoria's STEP program³ is helping councils implement such a framework, but there is still some way to go.

³ The STEP program commenced in 2003 and is designed to assist councils to improve their asset management processes with support from a consortium of asset management consultants. All councils are encouraged to participate in the program.

Recommendations

That councils:

- **complete the development of (and formalise) their asset management frameworks, as a priority**
- **link their capital budget process to their asset management plans**
- **implement systematic and consistent analysis of all major new asset proposals, through the preparation of comprehensive business cases**
- **develop long-term funding and cost-reduction strategies to ensure they have the funds needed to renew assets or acquire new assets, in line with their asset management framework**
- **review the timing of their capital budget process, to ensure sufficient time is allowed prior to the approval of the budget to obtain and analyse relevant data on estimated costs, and to allow for earlier commencement of approved projects**
- **review their internal reporting to ensure it captures important milestone data for the life of each major capital project, as well as annual data.**

1.2.10 Review of Warrnambool City Council financial management practices

In June 2004, the Ombudsman referred a number of allegations to my Office for enquiry about the adequacy of Warrnambool City Council's financial management practices. This report sets out the results of our examination of these allegations. In all, some 15 allegations were investigated covering the 13-year period 1992 to 2004.

While our investigation found the majority of allegations not to be substantiated, or not able to be substantiated due to insufficient evidence, a number of issues were identified, including:

- non-compliance with the *Local Government Act 1989* requirements for a major purchase and the funding of employee long service leave entitlements
- non-compliance with the Council's own procurement policies for 4 sizeable capital projects examined
- inadequate management and reporting of the 2002 and 2003 Fun 4 Kids festivals, which represent a major annual activity of the Council

- inadequate risk assessment during the early 1990s for some of the Council's industry development and facilitation projects
- scope for improved management practices over certain major capital works projects and a rental property.

One of the allegations referred to us focused on the financial standing and sustainability of the Council. While the Council's reported results over the past 4 years show a strong financial performance and position, this largely resulted from the receipt of significant capital grants over this period. After excluding capital receipts, the result was an underlying deficit, indicating that Council was not generating sufficient recurrent revenue to cover its costs of operations.

While the level of rates and charges raised by the Council is consistent with other regional cities, overall operating expenditure has been significantly higher.

The Council, in recent years, implemented various continuous improvement initiatives as part of the local government Best Value Program, aimed at strengthening its management practices and improving community outcomes. The Council also implemented various initiatives to assist in better managing its short and longer-term financial sustainability. Its financial projections to the year 2008 predict a progressively improving operating result and funding position.

Notwithstanding these initiatives and projections, there remains a need for the Council to continually review and refine its governance and reporting arrangements, and its project management procedures.

Recommendations

Several recommendations were made focusing on the need for the Council to:

- **ensure that all its purchases comply with the requirements of the *Local Government Act 1989* and its own procurement policies**
- **refine its budget setting, reporting and review processes associated with the Fun 4 Kids festival**
- **improve the quality of future capital project proposals submitted for council funding approval**
- **ensure that any future evaluations of potential asset acquisitions associated with industry facilitation activities, are preceded by sufficient analysis and risk assessment**

- **establish a periodic review process to ensure ongoing compliance with all tax requirements**
 - **continue to closely monitor its operating and cash flow positions over a rolling forward 5 year period, to ensure that its operations remain sustainable and sufficient cash is available to meet financial obligations**
 - **review the condition of its major infrastructure assets, to identify required capital works and develop funding strategies.**
-



2. Cheltenham and Regional Cemeteries Trust - Review of expenditure and related matters



2.1 Audit conclusion

In July 2004, 2 trust members of the Cheltenham and Regional Cemeteries Trust (the trust) expressed concerns to the Department of Human Services (DHS) about the expenditure of trust funds and related matters. DHS subsequently referred certain activities and transactions of the trust to my Office.

We examined the trust's governance processes, and selected expenditure and other transactions relevant to the concerns expressed.

We concluded that the trust:

- failed to manage a conflict of interest involving business arrangements with the Chief Executive Officer's (CEO's) son
- was unable to adequately control its ongoing business relationships with one of the CEO's son's company and had exposed itself to significant risk
- failed to attend to advice from DHS and from my Office to ensure that related-party agreements were transparent, fair and contestable, and entered into business arrangements with a company owned by another of the CEO's sons (and in doing so did not comply with its own purchasing policy)
- improperly used trust funds to purchase a vehicle for the CEO's wife's private use
- sold trust assets to staff and related parties without a transparent sales process or a policy to guide such sales
- in relation to its dealings with one contractor, failed to tender for significant work, obtained financial accommodation without gaining the necessary approval, paid contractor's costs it was not required to pay and entered into a lease of crown land that resulted in considerable cost to the state
- guaranteed a private loan for the CEO and his wife without obtaining the necessary approval
- failed to comply with existing purchasing policies on a routine basis
- illegally paid incentives to private businesses
- made substantial expenditures on items that may deliver a private benefit to trust members and staff, without having policies to guide such expenditures
- failed to maintain adequate security over its fixed assets.

The trust has made, and continues to make, substantial expenditures that are excessive by public sector standards and not for the purposes of the trust.

Despite continually being made aware of appropriate purchasing practices by DHS and my Office, the trust over several years engaged in practices that were unacceptable for agencies in the public sector.

The entry into and the ongoing relationship between the trust and Major IT and MRG Contracting, companies owned and operated by the sons of the CEO, were not transparent, fair and contestable and have exposed the trust to significant ongoing risks.

Trust members must have full knowledge and understanding of their role and responsibilities in governing the operations of a public sector agency. To this end, the trust must urgently improve its governance arrangements, to ensure trust members and staff comply with the legislative and public sector requirements.

The establishment in March 2005 of the State Services Authority will provide the opportunity to strengthen the governance, accountability and performance of public bodies such as this trust.

RESPONSE provided by Secretary, Department of Human Services

The department has no operational involvement with the Trust and is not in a position to independently verify the facts set out in the report. However, the department is not aware of any matters that would suggest that the report is anything other than correct and fair.

The department accepts the report and its recommendations. The department views the matters identified in the report as very serious. We are considering mechanisms to most appropriately implement the report's recommendations.

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The report often refers to the relationship between the CEO and members of his family. The CEO is no longer with the Trust and arrangements are being developed to ensure open and transparent compliance at all times in the future.

The Trust wishes to assure the Department of Human Services and the Auditor-General it will implement the recommendations contained within the review to improve its methods and develop a framework for analysing Trust activities.

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust - continued

The Trust is reviewing all policies which will lead to the establishment of better systems and procedures to ensure compliance in the future. Part of the review will include the development of a “performance focus” for the members of the Trust to ensure the Trust always has a good understanding of the business and the strategic context in which it operates.

The review will ensure that the Trust, at all times, provides accountability, strategy formulation, monitors and supervises and develops policy.

The Trust is proud of the work undertaken to develop much needed facilities for our community. Although, at times, the paper trail may have been incomplete, the objectives of the Trust have been achieved with the development of Bunurong Memorial Park without any financial assistance from the Victorian Government. We are very proud of this effort.

Bunurong Memorial Park is the only “green field” cemetery developed in Victoria in more than 50 years and it is being developed without any guidance, direction or funding from the state government. The Trust has delivered the state government and its community a magnificent asset.

The Trust does not believe the arrangements with Major IT places the Trust at significant ongoing risk. As part of good business practice, this contract is being reviewed and future information technology arrangements are being assessed.

With respect to MRG Contracting, all arrangements have been concluded and any future work (offered to any contractor or supplier) will only be considered following a fair and competitive process.

The Trust has embraced, in previous years, the review and improvement of its policies and procedures. It welcomes constructive feedback about its performance which will assist it to improve its practices.

The Trust welcomes the establishment of the State Services Authority which has the potential to offer guidance to strengthen the governance, accountability and performance of all Trusts.

2.2 Background

The Cheltenham and Regional Cemeteries Trust was established in 1865. The trust manages 3 cemetery locations: Cheltenham Memorial Park, Cheltenham Pioneer Cemetery and Bunurong Memorial Park. In total, it employs 29 staff including a CEO, 13 administrative staff and 15 outdoor staff.

The voluntary 8-member trust oversees the administration of the cemeteries. The trust's functions and powers are set out in the *Cemeteries Act 1958*¹. The trust meets each month to discharge its responsibilities.

Members of the trust have extensive cemetery experience. The chairman and deputy chairman have been members for 39 and 36 years, respectively, and both are life members of the trust.

Following changes to the Act in 1996, trust members are now appointed for a maximum period of 5 years. There is no limit to the number of 5-year terms that members can serve.

The CEO of the trust was appointed in 1995. The CEO advised the trust in mid-2004 that he would not be renewing his contract which expired on 31 December 2004.

In July 2004, 2 trust members expressed concerns to DHS about the expenditure of trust funds and related matters. Following discussions with DHS, I decided to examine these concerns under the authority of the *Audit Act 1994*.

2.3 Purpose and scope of the review

The purpose of the review was to assess:

- the validity of the concerns expressed by the 2 trust members
- whether trust expenditure was appropriate, reasonable and had been properly incurred and authorised, in line with the trust's policies and procedures
- whether other areas of trust operations (such as the recording and disposal of fixed assets) were satisfactorily managed.

We also examined a sample of large value payments needing trust approval, public tenders or quotations, as well as a sample of payments for:

- travel costs
- entertainment expenses
- reimbursement of personal expenses to staff, CEO and trust members
- payments to related parties (such as family members and ex-employees).

¹ Cemetery trusts are statutory authorities accountable for public money dedicated to cemetery purposes. The function of a trust is: (a) to properly and efficiently manage and maintain each public cemetery for which it is responsible; and (b) to carry out any other function conferred on it by (or under) the Act or any other Act.

In addition, we examined other financial records and documentation as we saw fit, and held detailed discussions with staff, trust members and DHS representatives.

2.4 Transactions with related parties

2.4.1 Contract for information technology services

Concern expressed to DHS: *There was a conflict of interest in the trust's assessment and selection of Major IT Pty Ltd (Major IT), a company owned and operated by one of the CEO's sons to provide information technology services to the trust.*

In 2001, the trust outsourced the provision of information technology services to Major IT. A written agreement between the trust and Major IT was made in August 2001, to apply for 12 months. The arrangement with Major IT continued up until late 2003. The trust at this time, conducted a competitive tender process and decided to award a contract to Major IT to provide information technology services for a further 3 years.

We identified a number of matters concerning these arrangements:

- The trust did not analyse the costs or benefits of appointing a permanent information technology resource in preference to retaining the outsourced arrangements, despite one trustee suggesting such an analysis before the 2003 tender.
- As part of the competitive tender process, one trust member asked for an independent review of the selection criteria and of the assessment report (which recommended the re-appointment of Major IT). This request was not approved by the trust, although the trust's tendering policy provides for "independent outside expertise to be obtained where considered appropriate".
- We found no evidence in the trust's minutes, or in other documents, of a formal process to identify or manage the conflict of interest implications of the tender process. These implications arose through the direct involvement of the CEO in the preparation of tender information, the assessment of tenders and the ongoing management of the arrangement.
- The CEO provided his son with details of the request for tender before the trust approved it, and 5 months before the request for tender was made available to other potential tenderers.
- At the time of our review, the trust had not signed a contract with Major IT to formalise the decision it made in late 2003.

- At the time of our review, Major IT had not provided management information (such as system downtime, or its response time) to the trust to enable the company's performance to be assessed. Such information is normally required of providers of outsourced information technology services.
- Under the terms of the trust's late-2003 decision, which govern the provision of services by Major IT, the company is required to provide a minimum of 75 hours of onsite support to the trust each month, at a cost of \$4 300. This totals \$51 600 a year, and is prepaid monthly. The agreement allows for further payments (at the same hourly rate) for additional services requested by either the CEO or the cemetery manager. These services may include additional onsite system administration, development and staff support, and purchase and installation of hardware and software. In the last 3 years, payments totalling about \$460 000 have been made to Major IT. For the year ended 31 December 2004, payments to Major IT were almost \$110 000 above the minimum agreed amount of \$51 600. As the trust has failed to formalise its agreement with Major IT with a contract, we are concerned that it does not have the grounds to control the arrangement (including to effectively assess the company's performance and monitor payments for additional services).

Conclusion

Providing tender information to Major IT in advance of other potential tenderers was inappropriate, and breaches all the tender guidelines of which we are aware.

We consider the failure of the trust to formally identify and manage the conflict of interest that arises when a CEO is involved in the awarding of a contract to his son to be of significant concern.

As the trust did not analyse options for the provision of information technology services, it is not in a position to determine the cost-effectiveness of its arrangement with Major IT.

As the CEO was an important force in the development of the trust's information technology capability since his appointment in 1995, the trust will be more dependant on Major IT after the CEO's departure. This increases its business risk.

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The 7 dot points made within the commentary are noted. It is unfortunate that in many cases the Trust was not aware or made aware of these matters. The Trust is now aware of the actions taken by the CEO and has moved to ensure a repeat of these issues does not occur.

However it ought to be pointed out that:

- *The Trust was not made aware of the advance notice provided to Major IT by the CEO and does not support such action.*
- *The Trust has considered options for the provision of technology services and considered the most professional advice could be obtained from outsourcing this function to an expert company. Other Cemetery operations are now utilising similar methods which are considered to be cost effective.*
- *Prior to the conclusion of the current contract a detailed assessment of technology provision will be undertaken to ensure security of our services. The Trust is implementing a strategy based on risk assessment to reduce our exposure.*
- *The Trust considers the risk of data loss to be low. A “backup system” test was carried out in mid 2004 and showed that the system is readily restorable within 24 hours.*
- *Contractual content and arrangements have not yet been agreed upon and formalised. The Trust will review the current arrangements.*

2.4.2 Contract for paving and concreting

Concern expressed to DHS: *There were inadequate controls over arrangements for concreting work undertaken by MRG Contracting Pty Ltd (MRG Contracting), a company owned and operated by another of the CEO’s sons.*

MRG Contracting has provided paving services at Bunurong Memorial Park since 1996. This company was sourced from Queensland to “provide a paving style which was not available in Victoria”².

In March 2003, DHS wrote to the trust to advise it that selection processes for related-party agreements had to be “transparent, fair and contestable”, to avoid any allegations of impropriety³. In April 2003, my Office also wrote to the trust to express concern at the lack of a competitive tender process for services (both paving work and information technology services) provided by related parties.

² Advice provided by Acting CEO, Cheltenham and Regional Cemeteries Trust, 6 January 2005.

³ Department of Human Services, letter to chairman, Cemetery Trust, 21 March 2003.

In response, the trust developed a purchasing policy in July 2003 to clarify responsibilities for dealing with related parties. The policy outlined the purchasing method (quotations or public tender) required for different dollar values⁴. If the preferred supplier was a related party, the policy also required the chairman to be advised, and to give his approval before the purchase occurred. Such items must also be disclosed in the monthly financial reports to the trust.

Our review of all payments made to MRG Contracting in 2004 showed that the trust's purchasing policy was not complied with. Figure 2A shows our findings.

FIGURE 2A: COMPLIANCE WITH PURCHASING POLICY FOR SERVICES PROVIDED BY MRG CONTRACTING IN 2004

Date and amount (inc. GST) of payments to MRG (a)	Reason for payment	Method of purchase in accordance with purchasing policy	Approval by chairman before purchase	Purchase notated in monthly Trust report
November 2004, \$11 880	Paving at rear of chapel	No. The policy required 2 written quotes. The trust relied on quotes submitted 2 months earlier (in September 2004) for different work to award the contract to MRG Contracting. MRG did not submit the cheapest quote. The reasons why they were awarded the November work were not documented.	No	No
December 2004, \$39 600	Deposit for work to pave a new entry area (650 m ²) at a total cost of \$80 500	No. The policy required 3 written quotes. The trust requested 3 quotes but only received 2. MRG did not submit the cheapest quote (\$27 918) but were awarded the work. The reasons why they were awarded the contract were not documented. After the quotes were received, the scope of the project changed - the size of the area to be paved increased 160 per cent. MRG is to complete the paving at a revised cost of \$80 500.	No	No

(a) Works were performed at Bunurong Memorial Park.

Source: Information obtained from expenditure vouchers and provided by the trust.

⁴ The trust's purchasing policy requires one verbal quote for purchases up to \$5 000, 2 written quotes for purchases up to \$25 000, 3 written quotes for purchases up to \$100 000 and public tenders for purchases over \$100 000. This policy does not apply to the purchase of memorial items unless the item is more than \$100 000, in which case the purchase will be referred to the Trust for approval.

Conclusion

The trust awarded considerable work to MRG Contracting in contravention of its purchasing policies, including importantly, the chairman's approval if the preferred supplier was a related party. It is of considerable concern that the trust did so despite prior correspondence from DHS and from my Office about the need to follow proper purchasing procedures, and despite having developed a purchasing policy as a consequence of that correspondence.

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The Trust has reviewed its purchasing policies and implemented systems to ensure procedures are followed by staff and the Trust.

It needs to be noted that:

- *Staff are required to inform (in writing) of any pecuniary interest, conflict of interest or secondary jobs and other matters that may cause the Trust to be non-compliant.*
- *Trust members and senior staff are to inform the Chairperson prior to the commencement of meetings of any conflict of interest which are not already noted in their annual declaration.*
- *A review of recently completed projects and current projects has been completed and adjusted where possible. Where compliance was not achieved, a notation on file has been recorded.*
- *The new CEO is to provide a report to Trust meetings which advises whether the Trust has complied with its policies and procedures as well as legislative obligations.*
- *Arrangements with MRG Contracting P/L have been concluded.*

2.4.3 Sale of CEO's trust vehicle

Concern expressed to DHS: *The CEO's trust vehicle was sold to his son without the prior knowledge or approval of the trust members.*

In February 2002, a motor vehicle (a Ford Fairlane Sedan, purchased new in November 1999) that was owned by the trust and driven by the CEO was sold to one of the CEO's sons. The vehicle had been due for retirement, and the son had expressed an interest in purchasing it.

The vehicle was sold for \$27 272 (excluding GST). The sale resulted in a profit to the trust of \$1 564. The CEO told my Office that he obtained 3 market valuations of the vehicle before the sale, which valued the vehicle at \$21 800 (2 valuations, excluding GST) and \$22 700 (excluding GST). One valuation of \$21 800 was sighted by audit. No one else was given the opportunity to purchase the vehicle. Between 2002 and 2004, other assets (including a television, 2 laptop computers and a refrigerator) were also sold by the trust to select staff/parties without the use of a transparent process.

The trust members were not consulted about the sale of the motor vehicle to the CEO's son, or about the sale of other assets to related parties.

At the time of the vehicle's disposal in February 2002, the trust did not have a policy or procedures about the sale of assets. In June 2004, the trust developed a policy about the purchase, loan and disposal of trust assets⁵.

Conclusion

We are concerned that trust assets were sold to staff and related parties without a policy to guide such sales, and without the use of a transparent process.

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

It should be noted the Trust was not disadvantaged by the sale, however this practice will not occur in the future.

All assets will be disposed of in a manner demonstrating the best price has been achieved. Generally, items to be disposed will be sent to auction or via a competitive process. Items will not be sold directly to individuals unless other competitive processes have failed. The Trust's policies are being amended to reflect this process.

2.4.4 Purchase of motor vehicle for CEO's wife

Concern expressed to DHS: *A motor vehicle was purchased by the trust for the private use of the CEO's wife without the prior knowledge or approval of the trust members.*

In April 2000, the CEO purchased, with trust funds, a vehicle (a Ford Mondeo Sedan) costing \$30 303 for his wife's private use. The vehicle was registered in the trust's name and was included in its fixed assets register.

⁵ For further comment about fixed assets, see later in this report.

The CEO has, between April 2000 and December 2004, paid the trust \$139.64 each week for principal and interest amounts to cover the cost of the vehicle.

Since the purchase of the vehicle, the CEO also paid:

- vehicle registration, petrol and maintenance costs
- interest of 6 per cent per annum and depreciation cost
- fringe benefits tax on the insurance premium for the vehicle (which was paid by the trust).

In December 2004, the CEO obtained an appraisal of the market value of the vehicle and paid the trust in full for the balance outstanding on the vehicle.

The CEO told us that the purchase of the vehicle was discussed with, and verbally approved by, the chairman of the trust, but was not raised with the full trust for discussion and approval. We found no documentation to formalise the trust's purchase of the vehicle on behalf of the CEO's wife, nor documentation of the CEO's undertaking to meet the vehicle's costs.

Conclusion

Trust funds should not have been used to purchase a vehicle for the CEO's wife's private use, as such a purchase does not fall within the purpose or functions of the trust. Accordingly, the purchase should not have been allowed.

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The Trust will not allow any such purchase to occur in the future.

Recommendations

- 1. That the Cheltenham and Regional Cemeteries Trust:**
 - **review its tendering policy, practices and processes to ensure that all aspects of all its procurement activities are governed by a policy that meets or exceeds the standards set by the Victorian Government Purchasing Board**
 - **immediately amend the contracts and performance requirements of all staff to include the requirement to adhere to procurement policy, and enforce this requirement in future**

- **engage an independent party to develop and assess options for the future provision of information technology services to the trust, and to make recommendations**
 - **as an interim measure, formalise the current arrangements with Major IT for the delivery of information technology services**
 - **implement rigorous controls over approvals for information technology services in addition to the minimum agreed services**
 - **not approve expenditure or asset purchases that are not directly relevant to the trust's objectives and operations.**
- 2. That DHS ensures that trust members have appropriate skills and expertise to effectively discharge their responsibilities.**

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The Trust agrees with the recommendations.

The Trust has already commenced implementation of recommendation number one and will complete all actions (except dot point 3) by 30 June 2005. Dot point 3 will be implemented and completed before the end of the current IT contract which concludes at the very latest at 31 December 2006.

The Trust will correspond with DHS with respect to implementing recommendation number 2.

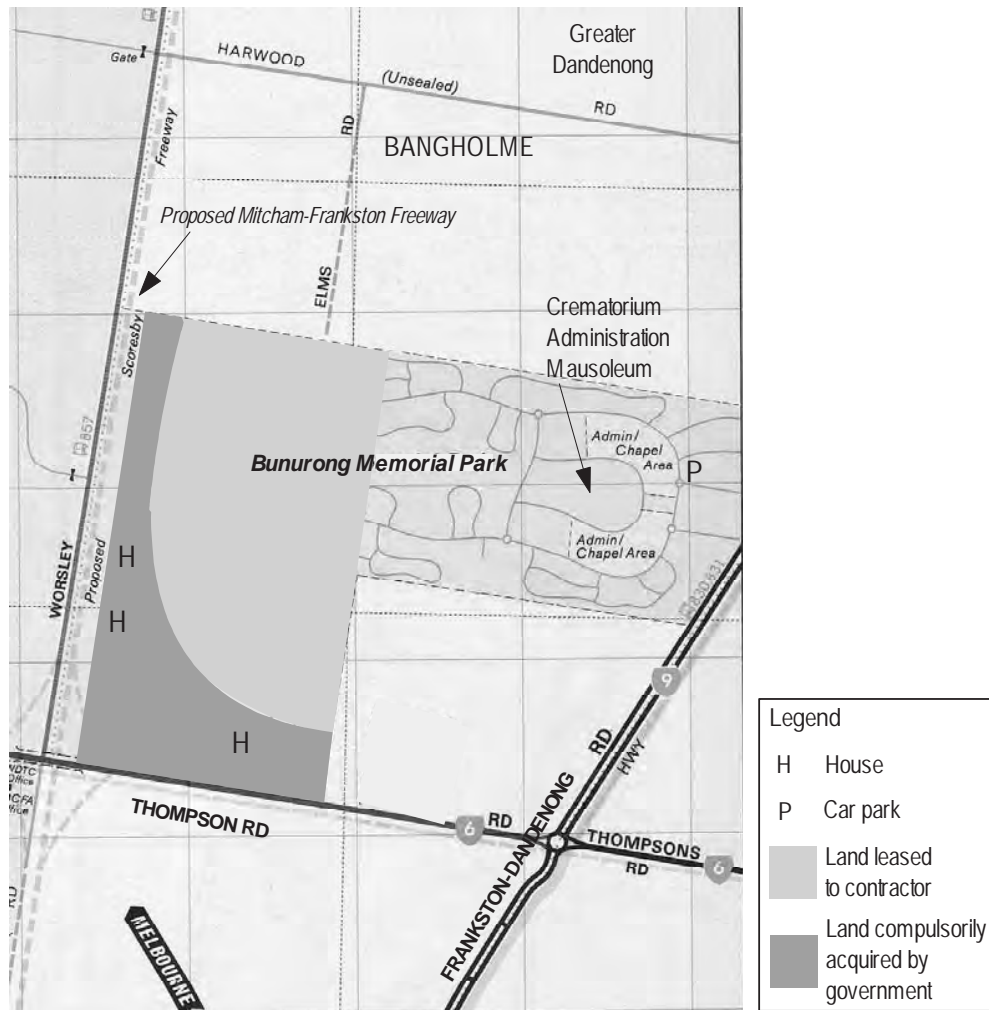
2.4.5 Lease of trust property

Concern expressed to DHS: *Inadequate process for granting a lease over trust land as compensation for the construction of a cemetery car park by a contractor. Specific concerns were that:*

- *because the cost of the car park was not formally determined, it was not possible to assess if the lease arrangement was appropriate*
- *the process of negotiating the lease left the trust with no option but to approve it when it finally became aware of it*
- *a planning permit required for the intended use of the leased land was not sought or granted by the local council.*

Figure 2B shows the location of Bunurong Memorial Park, its car park, land leased to a contractor, and land acquired by the government for the proposed Mitcham-Frankston Freeway.

FIGURE 2B: CEMETERY LAND AND LAND ASSOCIATED WITH FREEWAY



Source: Copyright Melway Publishing 2004. Reproduced from Melway Edition 32 with permission, map number and reference 98 H5.

Car park construction

The trust manages 3 allotments of crown land (totalling 78 hectares) that are currently in excess of its needs. It does not expect to use this land for another 30 to 40 years. There are currently 3 houses on this land. The trust had leased 2 of the houses, while the third was in poor condition and was uninhabited.

In 2001, a contractor that had undertaken previous work for the trust, submitted an estimate of \$235 009 to construct a car park on cemetery land. We were advised that additional work (such as drainage) increased the total cost of construction to about \$250 000. The car park was for the use of trust staff and visitors to the cemetery.

The trust awarded the work to the contractor without publicly tendering the work or seeking other estimates.

The contractor's desire to construct the car park in exchange for the lease of the 3 unused allotments was first raised in a November 2001 trust meeting. The meeting resolved to ask the contractor to develop a proposal for consideration by the trust. A report on the proposed lease was not presented to the trust until its May 2003 meeting of the trust, at which the trust approved the lease agreement from 1 July 2003.

The CEO told us that at no stage was a commitment given that the trust would lease the property to the contractor in advance of the trust's approval of the arrangement. The CEO also told us that work started on the car park on the understanding that the trust had the option to either pay for the car park, or consider a proposal for the lease as a means of deferring payment. The trust had limited cash at the time the car park was completed in early 2002, and did not pay the contractor.

By entering into this arrangement, the trust in essence obtained temporary finance and was required by section 8A(1)(b) of the *Cemeteries Act 1958* to obtain the prior approval of the Treasurer to do so. The trust did not obtain the required approval.

The trust has engaged the contractor to provide other works and services over the last 4 years, at a total cost of about \$670 000. These arrangements have also been entered into without contestable selection processes.

Leasing arrangement

The lease approved in July 2003 provided for the contractor to lease the 3 allotments of crown land for 10 years (to June 2013) at a total cost of \$250 000 (\$25 000 a year). This amount was not to be paid by the contractor but was considered to discharge the trust of its obligation to pay for the car park works. The trust's existing tenants (who paid a total rent of \$22 663 a year) were to remain in the properties and were to pay their rent directly to the contractor (as the tenant of the allotments). After the lease was granted, the contractor renovated the uninhabitable house (at his own cost) and then rented it out.

Under the arrangement, the contractor would gain access to a suitable site for his soil mixing business, and the trust would gain a secure tenant for the land it did not currently need. The trust would also have access to soil for use in the cemetery, and to heavy earthmoving equipment, when it required.

In order to use the leased land for his soil mixing business, the contractor was required by the terms of the lease to obtain a council permit. At the time the lease was signed, a permit had not been obtained.

In August 2003, the trust submitted a planning application on behalf of the contractor to enable him to use the land for his soil mixing business. In May 2004, the council notified its refusal to grant the permit on the grounds that the proposed use was “inconsistent with the purpose of the land as zoned”⁶. At the time of our review, the tenant continued to occupy the trust’s land and stored soil and heavy equipment on it, as well as grazed cattle and obtained rent from the house properties.

The lease required the tenant to obtain the necessary approvals to use the land. Despite this provision, the trust has incurred costs of more than \$3 500 preparing site plans and planning reports, lodging the permit application with the council and liaising with the council officers who considered the permit application.

Impact of freeway works

In May 2004, a major part of the leased land was compulsorily acquired by the state government for the construction of the Mitcham-Frankston Freeway⁷. The trust told us that it will seek compensation from the government for the land compulsorily acquired.

The land acquired is crown land and, under the *Mitcham-Frankston Project Act 2004*, no compensation is payable to an agency occupying it. However, parties with an interest in land to be compulsorily acquired (other than agencies), may be entitled to compensation.

The lease included a provision whereby the tenant acknowledged that the leased land might be affected by freeway works. The tenant agreed to waive any possible right to compensation or rent reductions if there was an interference to the premises, other than in the case of “substantial interference” (where the premises were rendered unfit for occupation or use by the tenant). The lease provided that if there was substantial interference, the tenant would be entitled to determine or end the lease, without compensation by the trust. The lease protected the trust from paying compensation, but did not provide the state with the same protection.

⁶ Land was zoned for “cemetery and crematorium” purposes.

⁷ The leasehold interest was acquired as per a Notice of Acquisition published in the Government Gazette on 13 May 2004.

The contractor applied for, and received, compensation of \$214 032⁸ from the state. This was compensation for the impact of acquisition on the contractor's business: 2 of the 3 houses are to be demolished, and the contractor will not be able to collect rent on them over the remaining lease period.

Legal advice obtained by Vic Roads described the lease as "unusual". The lease gives the tenant the right to end the lease - without compensation from the trust – in the event of "interference which affects a substantial portion" of the leased land. At the date of our review, the tenant had not ended the lease. However, should the tenant choose to end the lease, the trust would be released from the remainder of its debt to the contractor. The tenant, however, would have received considerable compensation from the government.

Conclusion

The trust did not tender construction work for the car park, although the cost of works was significant. It has also awarded other work to the contractor in recent years without competitive selection processes being used. This is contrary to accepted public sector purchasing practices.

The trust should not have met the costs of obtaining a council permit for the contractor to use the leased land. These costs should have been paid by the contractor.

The trust obtained financial accommodation without seeking the approval of the Treasurer, which it was legally required to do.

The trust entered into the lease agreement aware that the land would be affected by construction of the freeway. While the trust protected itself from the payment of compensation to the tenant, the lease of the land resulted in the state having to pay considerable compensation to the tenant.

Recommendation

- 3. That the Cheltenham and Regional Cemeteries Trust ensure that there is:**
 - **adequate and timely consideration by the trust of key decisions**
 - **compliance with legislative requirements and purchasing policies.**

⁸ Payment comprises \$212 500 compensation and \$1 532 interest. Compensation represents the difference over the 10-year lease term between the rental that could have been earned prior to acquisition and the loss suffered after acquisition of the land by the government.

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The Trust acknowledges and accepts the comments, conclusion and audit recommendation. However, the Trust sought legal advice on the transaction and the Auditor-General's Office audited the transaction.⁹

No such arrangement will be considered in the future. The Trust's policies and procedures have been adjusted to ensure compliance. The Trust will continue to adapt its reporting arrangements to strengthen its governance roles and duties.

2.4.6 Renewal of CEO's contract

Concern expressed to DHS: *The CEO's remuneration exceeded state government limits when bonuses were taken into account. There was also a lack of performance criteria by which to assess the CEO's performance and to calculate his bonuses.*

The Government Sector Executive Remuneration Panel (GSERP) monitors adherence to the government's policy on executive remuneration¹⁰ by statutory authorities, such as the trust. The GSERP had not been established when the CEO was re-appointed in January 2000.

The CEO had a 5-year contract ending on 31 December 2004, extendable for a further 5 years. Under the contract, the CEO was responsible to the trust members to manage the affairs of the trust, and was paid a base salary (excluding superannuation) to do so. The CEO was also to be provided with a fully maintained and serviced motor vehicle (a Ford Fairlane Ghia or similar vehicle), a mobile phone and a trust credit card if required. The trust would also pay for the CEO's home telephone expenses and for the CEO and his wife to attend 2 specified conferences each year. The contract provided for regular performance appraisal, using such criteria as the trust thought fit.

Each year, the Salaries Committee which consists of 3 trust members, reviews salary levels and performance of the CEO and staff.

⁹ The Auditor-General's Office audited transactions associated with the arrangement as part of its annual financial statement audit. This audit did not extend to reviewing the appropriateness of the lease arrangement.

¹⁰ The government's policy on executive remuneration ensures that it is not excessive, and that where increases are appropriate, they are broadly in line with wage movements in the general community and, in particular, with public sector levels.

At the date of our review, the CEO's remuneration was substantially higher than allowed for under the government's remuneration policy. Specifically:

- the CEO's total remuneration package at June 2004 was about \$179 150¹¹, while the GSERP told us that the applicable remuneration for the role was between \$100 000 and \$120 000
- the CEO did not have a written performance plan with criteria against which to assess his performance, however he received remuneration increases and performance bonuses each year.

The CEO's employment contract also allowed for remuneration for certain services that contained an element of private benefit, such as payment of home telephone expenses (all call and rental costs, at about \$450 a quarter) and travel by the CEO's wife to attend 2 specified conferences each year.

The CEO told us that it was generally accepted for partners to attend funeral industry conferences, and that it was common practice in the USA, Europe and Australasia.

In June 2004, the CEO advised the trust that he would resign from his position, effective 31 December 2004.

Conclusion

GSERP was not in existence when the former CEO's employment terms and conditions were approved by the trust. Remuneration of the former CEO was substantially higher than that provided for under the government's current policy on executive remuneration.

Without appropriate documentation to support the annual review of the CEO's performance, the payment of annual increases and performance bonuses is not transparent.

Recommendation

- 4. That the Cheltenham and Regional Cemeteries Trust ensure that the remuneration of its future CEO is in line with government policy on executive remuneration.**

¹¹ Annual survey information provided by the trust to GSERP, 30 June 2004.

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The Auditor-General is correct in noting that GSERP had not been established when the CEO was re-appointed in January 2000. The appointment of the CEO and the salary arrangements were made in accordance with industry practice prevailing at the time.

The Trust has complied with the requests of the Department of Treasury and Finance through GSERP on salary increases over the relevant periods. The Trust's Salaries Committee does use "performance related criteria" in assessing the annual bonus of the CEO. The Trust accepts the recommendation and has complied with this in appointing its new CEO.

2.5 Other issues

In addition to the concerns expressed to DHS, our review also identified further concerns about the operations of the trust.

2.5.1 Trust guarantee of borrowing by CEO and wife

When the CEO commenced employment with the trust in February 1995, the trust agreed to act as guarantor for 6 months for a \$240 000 loan taken out by the CEO and his wife. The chairman told us that the trust provided the guarantee to facilitate the CEO's move from interstate to Melbourne.

The chairman and 2 trust members signed the guarantee on behalf of the trust. This constituted a borrowing in the name of the trust, and was not brought before a meeting of trust members for discussion and approval. Also, the trust did not obtain the Treasurer's approval, which is required under the *Cemeteries Act 1958*.

The CEO told us that the trust members who signed the guarantee were not aware of their responsibility to obtain the Treasurer's approval.

The financial institution to which the guarantee was made did not call on the guarantee at any time.

Conclusion

We do not consider ignorance of the legal requirement to obtain the prior approval of the Treasurer for borrowings to be a sufficient reason for not meeting the requirement. We are also concerned that a decision to commit the trust to a substantial financial guarantee which was not for the purposes or functions of the trust and was not considered by a meeting of all trust members.

Recommendations

5. **That the Cheltenham and Regional Cemeteries Trust require all substantial financial matters to be considered by a meeting of trust members in advance of commitments being made.**
6. **That the Cheltenham and Regional Cemeteries Trust ensure that it complies at all times with legislative requirements.**

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The Trust agrees with the recommendations. This arrangement took place over 10 years ago. The Trust confirms no such arrangement will take place again. The Trust will implement a “compliance” item at each Trust meeting as part of its improved approach to good governance. The Trust believes its reporting framework on compliance, financial planning and asset management will address any future issue.

2.5.2 Payments by the trust

In the past, the trust has not seen itself as bound by public sector requirements for expenditure and financial management. In recent years, both my Office (through the annual audit process) and DHS have repeatedly advised the trust of the need to observe public sector requirements for expenditure and financial management.

For example, in November 2003, DHS advised the trust that under the *Cemeteries Act 1958*, it could develop its own purchasing policies. It further advised that these policies should be guided by best practices outlined in Victorian Government Purchasing Board guidelines. In response, the trust developed some operational policies and procedures. However, from discussions with trust staff and the CEO, uncertainty remains about their responsibilities for expenditure and aspects of financial management in a public sector environment.

At the date of our review, the trust did not have policies about entertainment and hospitality expenditure, reimbursement of business expenses, employee and trust member entitlements, allowances and travel expenditure. It did, however, have reimbursement procedures. Most expenditures were supported by documentation and approved in accordance with the trust’s policies. The trust also ratified all cash payments as part of its review of the monthly financial report.

After considering the appropriateness (business-related) or reasonableness (amount) of certain trust expenditures, we identified the following concerns.

Commissions

In August 2001, DHS issued a newsletter to all cemeteries to advise that incentives paid to funeral directors and others were prohibited by the *Cemeteries Act 1958*.

In October 2001, the CEO entered into an agreement with a private business (that was not a funeral director) to become an agent of the trust and to promote the services of the cemetery, in return for a 10 per cent commission on sales of graves and memorial packages.

In the past 3 years, the trust paid a total of about \$40 000 to funeral directors and others to promote and refer business (such as burials, cremations and purchases of monuments and memorials) to the trust contrary to the requirements of the Act.

Entertainment and hospitality

Each year, the trust hosts a “fun day” for staff, their families and representatives of the funeral industry. The total cost of the 2004 fun day was almost \$19 000. The trust does not have a policy about entertainment or hospitality expenditure.

Conference attendances

The CEO’s employment agreement provided for the CEO and his wife to attend 2 specified conferences each year, at the trust’s expense. It is also usual practice for trust members, their partners, and some staff members and their partners to attend these conferences at the trust’s expense. For example, 9 trust members and staff and 8 partners attended the Australian Cemeteries & Crematoria Association 2004 conference in Perth, at a total cost to the trust of about \$45 000. This included dinner for 34 people (at a cost of \$3 300) and 14 hospitality packs comprising a T-shirt, cap and stubby holder (at a cost of \$700).

The CEO told us that the trust does not have a policy about training for, or conference attendance by, trust members or staff. However, he told us that the trust considered attendance at such conferences to be open to all members of the trust and some staff and partners, as a means of expanding their knowledge of the industry.

Overseas travel

In the past 4 years, the CEO travelled extensively overseas to keep abreast of burial and cremation practices, and to source monumental materials. In each year, he travelled with his wife (and at times with the chairman and his partner) overseas on 2 or 3 trips for one to 4 weeks at a time. All trips were pre-approved by the trust, and the trust met the full travel costs (accommodation, airfares and sundry costs) of all parties. The trust was not generally provided with an estimate of the cost of the travel before it approved the travel, but was usually provided with this information and a report about the travel on the CEO's return. Trust minutes did not specifically note that the CEO's wife also travelled, except on one trip.

The trust does not have a policy about overseas travel or conference attendance by trust members or staff.

Credit card reimbursements

In line with his employment agreement, the CEO used his credit card for trust purposes. The CEO routinely incurred expenses on the card, and the trust paid:

- entertainment expenses (such as dining, liquor and golf day expenses)
- donations and gratuities
- airline club and hotel memberships
- credit card rewards program fees
- gifts for staff members (such as flowers and liquor).

We were unable to determine from the documentation made available to us whether all expenses related to trust operations.

The CEO occasionally excluded credit card items for payment by the trust on the basis that they were private expenditure.

The trust does not have a policy about entertainment or hospitality expenditure, or about donations.

Allowances and entitlements

At the time of our review, the trust paid a home phone allowance of \$150 a month to one staff member, and paid the phone account of another staff member in full¹².

The trust also provided fully maintained motor vehicles to 4 non-executive staff to travel to and from work, and for their private use. One vehicle was a Toyota Land Cruiser turbo 4X4 vehicle, valued at about \$48 000. The vehicles were not considered as part of staffs' remuneration packages.

¹² Neither staff member was the CEO.

The trust also paid for internet services provided at the homes of the trust chairman, deputy chairman and CEO.

The trust does not have a policy about allowances and entitlements provided to staff or trust members, including a policy about the private use of trust vehicles.

Conclusion

The trust appears to have acted in contravention of the DHS's interpretation of the *Cemeteries Act 1958* by paying incentives to private businesses.

We are concerned that the trust had made, and is continuing to make, substantial expenditures on items that may deliver a private benefit to trust members and staff, without having policies to guide such expenditures. It is essential that such expenditures be in line with comprehensive policies that protect the public interest and protect the trust from allegations of impropriety.

We are also concerned that some expenditure appears to have been excessive by public sector standards.

Recommendation

7. **That the Cheltenham and Regional Cemeteries Trust, in consultation with DHS, review its current expenditure policies and develop adequate policies to ensure that:**
 - **trust members and staff only incur, and are reimbursed for, expenses that are approved in advance and incurred in the conduct of trust business**
 - **payments made to, and on behalf of, staff and trust members are reasonable and comply with legislative and financial management requirements.**

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The Trust accepts the recommendation. The Trust is reviewing (and developing) all policies and procedures in conjunction with the development of model rules to be ready for the implementation of the new Cemeteries and Crematoria Act 2003 which applies from 1 July 2005.

The Trust will circulate the draft model rules, policies and procedures for comment following consideration by the Trust. The Department of Human Services will be requested to provide comment and the Trust will welcome that comment.

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust - continued

Commissions

The Trust does not believe that it has breached the Cemeteries Act and advises that it ceased this practice following advice from DHS in August 2001. No new commissions have been made since that time. The Trust has honoured contractual arrangements that it had entered into prior to receiving the advice from DHS in August 2001. Those “pre-August 2001” arrangements have now been finalised.

The Trust was not aware that the transaction with the private company could breach the Cemeteries Act 1958. The Trust was aware of the consultancy services provided to position and orient asian grave sites and believed that the arrangement in question related to promoting Bunurong Memorial Park as stated in the letter of offer. It is accepted that the letter refers to “commissions” and it could be inferred that this arrangement could be seen as a breach of the Cemeteries Act 1958. The arrangements were poorly drafted and did not reflect or indicate expectations of the Trust including compliance with legislation. The CEO has concluded the promotional arrangements with the company to ensure that there is no doubt about the Trust’s desire to be fully compliant.

A check of “inward correspondence” on Trust meeting agendas since August 2001 confirms that the trust members were not informed of the news-letter (August 2001) that details the department’s concerns about the use of incentives to attract use of a facility.

The Trust’s governance arrangements now include a compliance statement provided by the CEO. This statement is to inform the Trust as to whether the Trust is meeting its legislative obligations.

Entertainment and hospitality

The Trust accepts it should develop an “Entertainment and Hospitality Policy” and is in the process of developing such a policy.

Conference attendance, overseas travel

The Trust notes that the audit indicated there were no breaches of policy.

The Trust is developing an “Expenses, Allowances and Entitlements Policy.” Future conference attendance by members and officers (and partners) will be based on the policy developed. Trust members volunteer their time and receive no financial support from the state government. The Trust is in the process of developing a further policy which respects the effort and time provided by its volunteer members.

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust - continued

The Trust has developed a “green field cemetery” in less than 9 years, requiring significant travel to obtain world standard concepts for inclusion in the Bunurong Memorial Park master plan. With respect to members and officer’s (and partners) travel expenses, the Trust will require a report, from the CEO, for the Trust’s consideration which will include business reasons (justifications) for attendance interstate and overseas.

Credit card reimbursements

The audit indicated that there were no breaches of policy. The Trust wishes to confirm that the new CEO has been provided with a corporate credit card that must only be used in accordance with Trust policy and state government guidelines for the use of credit cards.

As previously advised, the Trust is developing an “Entertainment and Hospitality Policy.”

Allowances and Entitlements

The audit indicated that there were no breaches of policy. The Trust is reviewing and developing policies regarding allowances and entitlements (as discussed above) and motor vehicle usage.

2.5.3 Compliance with purchasing policies

The *Financial Management Act 1994* requires the trust to “implement and maintain an effective internal control framework over procurement activities”¹³. The trust has purchasing, tendering and ordering policies and procedures to ensure that purchases represent value-for-money, and are made in a fair and contestable manner, and that goods and services purchased are appropriate for the efficient functioning of the trust’s business.

Our review of expenditure identified instances where the trust had not complied with its policies and procedures, and instances where policies were not comprehensive. In addition to the issues involving related parties that we explained earlier in this report, we identified the following issues.

Staff regularly did not obtain quotations for goods and services (other than for the purchase of memorial items) as required by the trust’s policy. For example, we found numerous instance of 2 written quotes not having being obtained for purchases between \$5 001 and \$25 000. We found no documentation about why the trust’s policy had not been followed.

¹³ Standing Directions of the Minister for Finance under the *Financial Management Act 1994*, Department of Treasury and Finance, June 2003, p. 41.

Staff often did not prepare purchase orders for purchases, and details (such as the date of the order and the amount quoted) were often missing. Some orders were dated after invoices had been received.

Payments were made on faxed and photocopied invoices, with original documentation not presented.

The trust's payment terms and conditions were not stated on purchase orders and invoices.

Some services provided to the trust by related parties (such as staff and ex-employees) were not governed by written agreements and had not been subject to contestable selection processes. These included provision of catering in 2003 and 2004, to the value of \$8 100 a year; supply of granite in 2004, to the value of \$16 970; and cleaning services in 2004, to the value of \$60 000. We found no evidence, as required by trust policy, that the chairman had approved the purchase of these services or that they had been specifically noted in the monthly financial report presented to the trust.

Conclusion

We are concerned that non-adherence to the purchasing policies of the trust appears to be normal practice, and not exceptional.

Recommendation

- 8. That the Cheltenham and Regional Cemeteries Trust take all required measures to ensure that staff follow, without exception, its procurement policies.**

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The findings, conclusion and recommendations are accepted by the Trust. The Trust is in the process of implementing a system of monitoring that the Trust's policies are being carried out. The Trust will be informed regularly of procurement issues so it can consider the best methods of procuring services based on a business needs analysis. It is anticipated that all purchasing will be compliant by August 2005.

2.5.4 Fixed assets

The trust's assets register is not up-to-date. Although the trust's internal auditor noted this fact in May 2004, the trust had not, at the time of this review, taken action to bring it up-to-date. Our review also confirmed the findings of the internal auditor, that:

- about 80 assets (costing \$171 590, and having a depreciated value on 1 January 2004 of \$41 150) could not be located, and will have to be written-off. They include computer equipment and software
- several assets that were sighted were not recorded in the asset register
- items that had been disposed of about 6 months earlier were still recorded in the asset register
- serial numbers were not recorded in the asset register and all assets had not been allocated an ID number (which made it difficult to identify assets)
- the offsite location of some assets (such as at the office of Major IT, the information technology service provider) was not noted in the asset register.

In past years, a number of trust assets (such as a television, fridge and laptop computers) have been sold to staff. In May 2004, 2 laptop computers were sold at a total loss of \$1 320 to an associate of an employee of Major IT. This sale was approved verbally by the CEO. The trust did not have a policy or procedures about asset disposals.

In June 2004, the trust developed a policy about the purchase, loan and disposal of assets. The policy provided for assets to be disposed of by sale, trade-in, gifting, scrapping and abandonment. However, the policy did not specify which particular method of disposal to use for which particular assets, or how the disposal should be conducted.

In October 2004, the trust's internal auditors found that 4 of 7 assets disposals since the policy was developed (and which were not related-party transactions) had not been undertaken in accordance with the policy, insofar as relevant approvals had not been obtained.

Conclusion

The trust has invested heavily in state-of-the-art audio visual and computing equipment in recent years. It has failed to keep a complete and up-to-date register of its assets, which compromises the security of its investment.

Although the trust has developed asset disposal policies and procedures, we consider that they are not comprehensive and do not provide adequate guidance to staff about how to dispose of assets.

We are concerned with the high number of incidences of non-compliance with the trust's asset disposal policy.

Recommendations

- 9. That the Cheltenham and Regional Cemeteries Trust immediately bring its asset register up-to-date.**
- 10. That the Cheltenham and Regional Cemeteries Trust review its asset disposal policies and procedures to ensure that they provide adequate guidance.**

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The Trust accepts the findings, conclusions and audit recommendations.

The Trust is developing a detailed set of asset registers (fixed, mobile and technology) in conjunction with the work it is doing to comply with the International Financial Reporting Standards. It is anticipated the current assets registers will be improved to meet an acceptable standards by 1 July 2005.

A review of asset disposal policies and procedures will be completed as part of the development of new model rules and the review of Trust policies and procedures. Draft policies and procedures will be considered by the Trust and by external parties, including Department of Human Services, before 1 July 2005. An instruction has been issued for all assets are to be disposed through competitive processes such as an auction house or public tender or bidding process.

2.5.5 Use of fuel at Bunurong Memorial Park

The trust has a facility at Bunurong Memorial Park for refuelling vehicles. Relevant details of refuelling events (such as the date, total start and end fuel readings, quantity of fuel taken, vehicle registration and the signature of staff using the fuel) are recorded in a register. The register is reviewed periodically to check that access to fuel was authorised, and that the register is accurate. The register was last reviewed in July 2004.

We reviewed the register for 2004 and found that all vehicles that were recorded as having used the facility were authorised to do so. However, we found instances of fuel having been taken but not recorded in the register. The total quantity of fuel not accounted for was 111 litres in April, 94 litres in July, 50 litres in September and 118 litres in November.

Conclusion

We are concerned that the trust's reviews of the fuel register are not timely, and that significant quantities of fuel are being taken and not recorded in the register.

Recommendation

11. That the Cheltenham and Regional Cemeteries Trust:

- **implement procedures to ensure that all staff accurately record fuel accessed at the refuelling facility**
- **review the refuelling register monthly and investigate and resolve discrepancies immediately.**

RESPONSE provided by Chairman, Cheltenham and Regional Cemeteries Trust

The Trust accepts the findings, conclusions and audit recommendation. The Trust finds no evidence of theft but will review its fuel management practices. The Trust is considering options such as the use of fuel cards. The new CEO is considering this matter in conjunction with the motor vehicle policy and other policies and procedures.

In the interim, the new CEO has implemented daily monitoring of fuel at all sites to ensure that fuel is used appropriately and recorded accurately with any discrepancies being identified and resolved daily.



3. Qualifications and registration of medical practitioners in Victorian public health services



3.1 Audit conclusions

The regulatory framework for the practice of medicine in Australia is complex, with different Commonwealth and state responsibilities.

The Australian Medical Council (AMC), an incorporated body, is the national standards advisory body for medical education and training. The Postgraduate Medical Council of Victoria (PMCV), a non-profit association, supports the education and training of doctors who are not yet in specialty training programs. The Medical Practitioners Board of Victoria (MPBV), under the *Medical Practice Act 1994* (the Act), is responsible for registering doctors in Victoria. Registration includes student, provisional, general and specific registration. The MPBV is also responsible for intern accreditation.

Our review focused on the adequacy of procedures and processes for ensuring that medical practitioners employed in Victorian public health services are appropriately qualified to practise medicine. We examined the processes for registration of medical practitioners in Victoria by the MPBV, and the credentialing and other employment-related quality assurance processes used by 4 Victorian hospitals.

We concluded that:

- the systems used by the MPBV to register medical practitioners are generally consistent with the requirements of the Act. However, of the 8 files we examined, the level of documentation to support the registration of medical practitioners was, at times, inadequate
- where registration occurred under the specific registration¹ provisions of the Act and where supervised study or training arrangements were required for registration, the specific detail of supervised training and the skills and knowledge needs of the applicant varied considerably. Some applications simply indicated “as appropriate to the position”, some attached a copy of a generic training program and others attached detailed plans and rosters to show the number and seniority of staff supervising the medical practitioner
- the MPBV does not require a structured and consistent approach to supervised study or training for specific registration. However, it does take into account the appropriateness of the proposed supervised training, taking into account the individual needs of the applicant, when making the decision to register an applicant, or not

¹ Refer to Part 3.2.3 of this report for definition of specific registration.

- the systems and controls used by hospitals to ensure that medical practitioners are appropriately qualified, trained and supervised were better in larger hospitals than in smaller or more remote hospitals. The latter have a smaller pool of medical practitioners from which to recruit and they also are less likely to have well-resourced, formal structures to supervise or train medical practitioners.

Recommendations include that the MPBV strengthen its administrative processes and requirements for supervised training under specific registration, and that the Department of Human Services (DHS) support these endeavours.

RESPONSE provided by Secretary, Department of Human Services

I note that the conclusions refer predominantly to administrative processes of the Board relating to:

- *the adequacy of documentation to support the registration of medical practitioners*
- *the variable level of specific detail of supervised training and skills*
- *the lack of a consistent approach to supervised study or training for specific registration*
- *the level of scrutiny used when checking the authenticity of degree certificates.*

The department notes these conclusions and agrees to support the Board in its endeavours. The department agrees with all the recommendations.

RESPONSE provided by Chief Executive Officer, Medical Practitioners Board

The MPBV accept the conclusion reached within the scope of the audit. Recommendations such as collecting copies of qualifications etc. have already been implemented and other improvements are currently underway at the Board.

RESPONSE provided by Executive Medical Director, Outer Metropolitan Teaching Hospital

I found the report fair and balanced, contributing to future directions required in medical practitioner registration employment in Victoria.

3.2 Introduction

The regulatory framework for the practice of medicine in Australia is complex, with different Commonwealth and state responsibilities.

3.2.1 Australian Medical Council

The Australian Medical Council (AMC), an incorporated body, is the national standards advisory body for medical education and training. Among other things, it:

- accredits Australian and New Zealand medical schools and medical courses
- accredits Australian/Australasian programs of specialist medical training
- administers the AMC examination, which is designed to ensure international medical graduates possess the knowledge and skills of newly qualified Australian medical graduates.

3.2.2 Postgraduate Medical Council of Victoria

The Postgraduate Medical Council of Victoria (PMCV), a non-profit association, supports the education and training of doctors who are not yet in specialty training programs, namely:

- interns (first year HMOs)
- hospital medical officers (HMOs – generally second and third year doctors)
- international medical graduates who have not yet completed their AMC examinations.

The PMCV develops detailed standards for intern programs and regularly assesses organisations accredited to conduct these programs. The PMCV is currently developing draft guidelines for employers of new international medical graduates and Australian-trained registered medical officers.

3.2.3 Medical Practitioners Board of Victoria

Each state independently issues licences to practice medicine, and is responsible for establishing, assessing and monitoring the level of training and competence required to practice medicine within their jurisdiction. Under the *Medical Practice Act 1994* (the Act), the Medical Practitioners Board of Victoria (MPBV) is responsible for registering doctors in Victoria.

The MPBV is also responsible for intern accreditation. It has commissioned the Postgraduate Medical Council of Victoria (PMCV) to develop standards for this, and to conduct regular, in-depth assessments of Victorian hospitals to ensure that their training and supervision are sufficient to warrant accreditation as employers of interns.

The Act provides for the following categories of registration.

Student and provisional registration

Student registration applies to those undertaking undergraduate medical courses in Australian and New Zealand medical schools. Provisional registration is available for those undertaking an internship or supervised training for general registration.

General registration

Applicants with a medical degree from any Australian or New Zealand university are generally eligible for full registration as a medical practitioner with the MPBV after completing a one-year internship.

International medical graduates who have passed both the written and clinical parts of the AMC exam are also, following a one-year internship, generally eligible for full registration in Victoria. Such international medical graduates who complete the AMC examination (“AMC doctors”) have demonstrated equivalency with Australian medical graduates and qualify for the same specialisation, training, registration and employment avenues open to Australian medical graduates².

Specific registration

For applicants who have a primary medical qualification from a university that has not been accredited by the AMC³ and the applicant has not completed the requirements for general or provisional registration, specific registration, as defined by section 8 (1) of the Act, is required. The Act provides registration for:

- practitioners with a medical qualification that does not qualify them for general registration, so they can undertake supervised study or training, or undertake medical teaching or research [section 8 (1) (a)]
- candidates for the AMC examination to undertake training [section 8 (1) (b)]

² Membership of a specialist college is the responsibility of each college.

³ Limited to Australian and New Zealand universities.

- practitioners with a medical qualification from outside Australia that does not qualify them for general registration (as well as specialist qualifications in a field of medicine that are recognised by the relevant specialist Australian college) so they can practise in a medical speciality [section 8 (1) (c)]
- practitioners from another country who have exchanged practice with a registered medical practitioner for a limited period to practise (with permission of the relevant specialist Australian college) [section 8 (1) (d)]
- practitioners with a medical qualification that does not qualify them for general registration, but the MPBV decides meet an identified need in the community for a medical practitioner [section 8 (1) (e)]
- those whom the MPBV is satisfied will not practise while registered [section 8 (1) (f)].

Specific registration is an important pathway for international medical graduates to gain registration with the MPBV. Current policies of the MPBV allow graduates from any medical school listed in the World Health Organization's (WHO) world directory of medical schools up to 5 years of registration to undertake supervised study or training, including preparation for the AMC examinations.

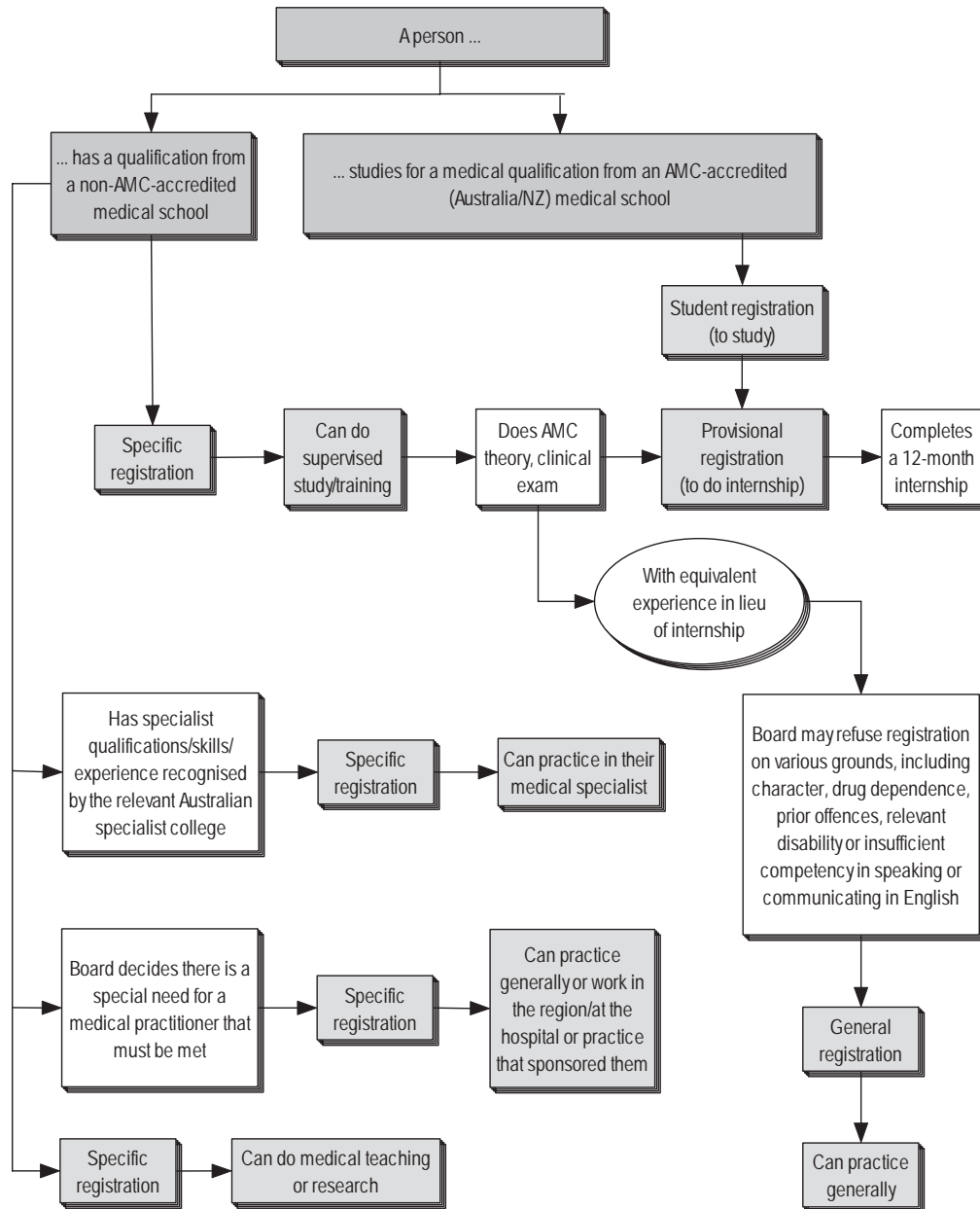
The MPBV does not review the quality of any of the medical schools on the WHO directory, nor does it undertake individual assessments of clinical, language or cultural competence. However, applicants seeking registration under section 8 (1) (b), 8 (1) (c) and 8 (1) (d) must first pass an English language test, administered by the AMC. Additionally, all specific registrations under section 8 (1) (a) and 8 (1) (b) undergo cross-cultural training either prior to registration or within the first 3 months.

Applications for specific registration must be made in conjunction with an employer request, and the employer (usually a hospital or similar institution) must submit a training program and supervision structure with each application.

Specific registration also includes those skilled and experienced specialist international medical graduates who may be assessed in their specialty by the relevant Australian college and, if accepted by that Australian college, can be registered by the MPBV to practise medicine in that specialty, without having to complete the AMC examinations.

At December 2004, the MPBV reported a total of 17 781 registered medical practitioners made up of 415 provisional registrants, 15 130, general registrants and 2 236 specific registrants. In addition, there were 2 155 medical students registered. Figure 3A shows the pathways leading to registration.

FIGURE 3A: PATHWAYS TO REGISTRATION BY THE MEDICAL PRACTITIONERS BOARD OF VICTORIA



Source: Victorian Auditor-General's Office, from information provided by the Medical Practitioners Board of Victoria.

3.3 Registration as a medical practitioner

3.3.1 Medical Practitioners Board of Victoria

In assessing whether medical practitioners working in the Victorian public health system were appropriately registered, we examined the MPBV files of 8 applicants to see whether the systems used by the MPBV in registering medical practitioners were consistent with the Act.

According to the MPBV's guidelines, all applicants must first complete a signed application form with all relevant documentation supporting the requirements of their particular category of registration. These requirements are publicly available on the MPBV website.

Following confirmation that their application is successful, applicants must then present (in person for their earliest registration):

- an original, or notarised copy, of their basic medical degree certificate
- evidence of satisfactory completion of a first year internship
- certification (within the preceding 3 months) of good standing from the last medical registration authority which granted registration
- a certified copy of their AMC certificate (where relevant)
- a current passport and visa (where relevant).

All files that we examined contained a completed application form showing the qualifications of the applicant and, where relevant, any limitations placed on the medical practitioner, such as the specific hospitals where the medical practitioner was permitted to work and any supervision and training arrangements.

We found no documentation on 6 of the 8 files examined that the applicants had presented in person, nor that the MPBV had sighted the originals of the required items. For example, one file only had a faxed copy of a qualification. The MPBV has no requirement that evidence of these items be placed on an applicant's file. However, since August 2002, the documentation maintained by the MPBV has been supported by an IT system (Outlook) that captures a number of documents electronically.

The level of detail about the supervised study or training arrangements stated on application forms for section 8 (1) (a) and 8 (1) (b) of the Act (specific registrations) varies considerably. Some sponsoring hospitals simply state "as appropriate to the position", some attach a copy of a generic training program and others attach detailed plans and rosters to show the number and seniority of staff supervising the medical practitioner.

The nature of training or supervision required by the Act is not specified. The hospitals we reviewed reported that those they sponsor for section 8(1) registration are generally accepted by the MPBV based on a copy of their medical credentials, and a letter from the hospital stating that the proposed employee will receive supervision and training.

New pre-registration requirements

In October 2002, the Victorian Government announced the implementation, in 12 months, of a "new standardised pre-registration assessment of medical skills and clinical knowledge, cross-cultural and communication skills" which an international medical graduate must pass prior to section 8 (1) (b) registration. This assessment tool was developed by the PMCV and passed to the Australian Government with the aim of developing a nationally consistent approach. Two years later, this new requirement for specific registration has not been implemented.

The AMC requires satisfactory completion of an English language test for candidates of the AMC exam seeking registration under section 8 (1) (b), 8 (1) (c) and 8 (1) (d).

The MPBV has also prepared a policy requiring English language competence of all specific registration applicants. This policy is now being reconciled with similar initiatives interstate with the intention of having a nationally consistent requirement. This is expected to be in place by early 2005.

These new requirements, when in place, will add additional responsibility on the MPBV to assess applicants' suitability for registration.

Conclusion

The systems used by the MPBV in registering medical practitioners are generally consistent with the Act.

However, on the small number of files examined, the documentation to show that the MPBV's guidelines were followed is inadequate. Such documentation normally comprises records of interviews, initialled check lists, signed photocopies of sighted originals and the like. While there was no evidence that any applicant may have presented a fabricated degree certificate from a medical school as genuine, such a certificate is a key document in the registration process. The risk of fraud should be acknowledged and documentation that this risk has been addressed should be clearly evident. The MPBV should develop a more rigorous way of checking the authenticity of degree certificates.

For specific registration under section 8 (1) of the Act, the MPBV's guidelines could be strengthened in relation to:

- the standards of supervised study and training programs it expects for these practitioners
- assessment of clinical knowledge, cross-cultural and communication skills.

RESPONSE provided by Chief Executive Officer, Medical Practitioners Board

The report title implies that ALL medical practitioners working in the Victorian Health Services were the subject of this audit. The information requested and audited by your department only advised on Overseas Trained Doctors working in positions that were supervised.

Our understanding is that some files examined were a number of years old and therefore would not reflect current administration processes.

The Medical Practitioners Board of Victoria developed a new information technology platform in mid-2002. Information of attendance of interviews and details of documentation presented are now kept on file or electronically stored.

The Medical Practitioners Board of Victoria in June 2004 instigated a complete review of all registration processes and protocols to ensure the new I.T. systems are delivering the most appropriate level of scrutiny and validation of credentials, etc during the registration processes.

The Medical Practitioners Board of Victoria is currently investigating the services provided by the "Education Commission for Foreign Medical Graduates (ECFMG) International Credentials Services (EICS)" to provide primary source verification of medical credentials of particular applications. ECFMG is the recognised world body providing this verification service in the medical area.

RESPONSE provided by Executive Medical Director, Outer Metropolitan Teaching Hospital

While there are great differences in hospitals, a standard pro-forma for registration may in fact assist small as well as large hospitals in meeting the requirements of the Board and in ensuring that the correct level of documentation is obtained.

As commented, the MPBV does not require a structured consistent approach to supervised study or training. A more detailed minimum standard for supervised training or study would be helpful if it was provided in a formalised manner.

3.4 Qualifications of practitioners employed in public health services

We expected that Victorian public health services would have systems to ensure that the medical practitioners they employed were registered with the MPBV, that their qualifications and credentials were checked, and that supervision and training arrangements, where required, were in place and carried out.

In making these assessments, we examined the adequacy of systems used by 4 public health services to:

- appoint medical practitioners and ensure that they were registered with the MPBV
- assess and supervise junior staff (interns and international medical graduates), in line with their conditions of registration.

We conducted interviews with senior medical management representatives and examined the files of 10 medical practitioners in each health service: a 270-bed metropolitan teaching hospital, a 250-bed regional teaching hospital, and a 33-bed rural hospital without full-time doctors, but visited by general practitioners from the community.

We also interviewed senior medical managers of a 60-bed hospital campus of a regional health service in order to inform ourselves in greater depth about the employment, supervision and training of specific registration practitioners, including international medical graduates.

3.4.1 Employment and credentialing systems

Background

Most Victorian public health services have a credentialing body to consider the qualifications and experience of the medical practitioners they employ and to credential them to work in a specific roles or parts of the service. This body normally includes the hospital medical director and senior specialists relevant to the position⁴.

The credentialing body assesses the qualifications and experience of a candidate. In most small rural hospitals, the hospital CEO, in conjunction with the medical director of a larger hospital, undertakes selection and oversees privileging of medical practitioners.

⁴ The safety and quality improvement framework for Victorian health services recommends a number of credentialing and continuing education strategies. See Victorian Quality Council. *Better quality. Better health care.* <http://www.health.vic.gov.au/qualitycouncil/strat_frame.pdf> viewed on 11 October 2004.

Larger rural hospitals and most metropolitan hospitals recruit and employ most of their staff directly. Most senior staff, such as specialists, are appointed on the basis of approval from the hospital's internal credentialing body. In some cases, a hospital might appoint a senior medical practitioner on the basis that they had been through the credentialing process at another, larger hospital.

Generally, junior staff, including medical practitioners undertaking their intern year and newly-arrived international medical graduates, are employed directly by the hospital, under supervision, and are required to undertake training.

An Australian medical graduate cannot progress from provisional to general registration without completion of one year of supervised clinical practice in an accredited institution⁵. The intern year is further regulated insofar as it must include one medical, one surgical, one emergency and one rural rotation.

About 15 per cent of the public health services medical work force⁶ is international medical graduates. In 2004, the MPBV granted specific registration to 2 236 international medical graduates, many of whom are employed in public health services to "undertake supervised study or training" as required under the Act. The majority work as HMOs or registrars, and are either preparing for a speciality or studying for the AMC examinations.

Conclusion

All the health services we reviewed had systems to ensure that the medical practitioners they employed were registered with the MPBV. All medical practitioners whose files we examined were appropriately registered. None of the health services independently verified the qualifications of registered medical practitioners, instead generally relying on the MPBV processes.

Each of the hospitals examined had credentialing committees. The committee of the small rural hospital had not needed to meet for over 2 years and the committees of the other hospitals only considered senior appointments.

⁵ All public hospitals employing interns must have their intern posts assessed and accredited by the PMCV.

⁶ Department of Human Services analysis, 2002. Figures are equivalent full-time.

A range of processes are employed for the appointment of international medical graduates, with larger applicant pools available to metropolitan and regional hospitals. Applications are usually unsolicited, with applicants required to attend interviews, to undertake various assessment tasks or hypothetical clinical scenarios, and frequently to accept trial or provisional employment periods before permanent appointment.

RESPONSE provided by Secretary, Department of Human Services

The department acknowledges the conclusion relating to “Employment and Credentialing Systems”. It should be noted that the department participated in the development of the national standards for credentialing administered by the Australian Council for Safety and Quality in Health Care (ACSQHC). Concurrently, the department undertook a review of credentialing and clinical privileging processes in rural Victoria. The review has been completed and the department is now working with rural and regional Directors of Medical Services to implement the recommendations. This will ensure a consistent and standard approach that will be applicable to local circumstances.

RESPONSE provided by Executive Medical Director, Outer Metropolitan Teaching Hospital

It is worth noting that all health services have systems in place to screen and assess senior appointments but that junior appointments are handled in a different manner. They are normally handled in the larger hospitals by an HMO Manager and in the middle sized hospitals a Medical Director or similar person. In some of the smaller rural hospitals, this can be quite difficult and some requirement should be made to help these hospitals to seek support from large hospitals in rural centres, and from nearby teaching hospitals in the case of metropolitan small hospitals.

It is recognised that health services would find it difficult to have a system in place to verify that qualifications were original and genuine and I think it also fair comment within the report that health services depend on the Medical Practitioners Board of Victoria to verify this matter. It would be extremely difficult for each Health Service to undertake this role given that countries such as China and India have such large populations and large number of medical schools. It is more correctly a role for the central registration authority.

3.4.2 Supervision of hospital medical practitioners

Background

A hospital medical team is typically overseen by a specialist or consultant, who is accredited by the relevant college, often has a private practice outside the hospital, and whose responsibilities include broad management decisions for each patient and teaching of the other team members.

Day-to-day patient management is undertaken by a registrar, who has been selected by their college to undergo training to become a specialist. The registrar's program of education and supervision is dictated and monitored by the relevant college.

The registrar teaches, supervises and is assisted by the HMO or intern, usually doctors in their first years of clinical practice who have yet to commence a specialty training scheme.

The largest hospitals in Victoria, the "teaching hospitals", reflect this hierarchical team structure, and an institutional commitment to teaching, from the PMCV accreditation for interns through to the college training schemes for registrars.

Smaller and more peripheral hospitals may have fewer registrars, interns or formal training programs. The HMOs in these hospitals have greater autonomy but fewer advancement opportunities, with limited supervision and training from specialists, who typically are not based in the hospital itself.

In the very small hospitals, patients are managed as required by general practitioners working in the community who visit the hospital on a fee-for-service basis.

Medical practitioners with specific registration are required under the Act to undertake supervised study or training, with registration specifying high, medium or low supervision of the training program by the employing body.

The level and formality of assessment and supervision arrangements varies among the hospitals reviewed. In general, the larger the hospital, the more extensive and formalised the process. This is explained in more detail below.



Medical practitioner treating a patient.

Outer metropolitan teaching hospital

This major teaching hospital benefits from a full 3-level medical team hierarchy, a culture of traditional apprenticeship-based supervision and training, PCMV-accredited intern training, and college-accredited training positions for registrars. As a major teaching hospital, it offers streamlined advancement opportunities for HMOs to become registrars. For this reason, and because it is located in Melbourne, many interns stay on with this hospital as HMOs, and relatively few positions remain vacant.

The teaching hospital structure provides for a high degree of interaction, supervision and teaching between HMOs and more senior doctors, providing high levels of ongoing assessment, supervision and training for all HMOs, Australian trained or otherwise.

Eighty per cent of this hospital's international medical graduates work in the emergency department, making up 16 of the 32 HMOs, in a department which also employs 8 registrars and 12 specialists. A specialist is "on the floor" until 11 pm each evening (6 pm on weekends) and on-call overnight, and a registrar is rostered on the floor 24 hours a day. Thus, junior overseas-trained doctors are always under supervision by experienced doctors.

Furthermore, the emergency department provides an ongoing training program, both within the department specifically and hospital-wide.

Regional teaching hospital

The inpatient departments in this hospital operate under the traditional teaching hospital structure, with 6 interns on rotating 10-week rural secondments, as well as 6 registrars, on 3 to 6-month secondments as part of their training scheme under the auspices of their college.

This hospital currently employs 20 overseas-trained HMOs based in the emergency department. The hospital employs a higher than average number of specialists at a cost of \$1.5 million a year to ensure that international medical graduates receive adequate supervision and training. These specialists also provide a 2-hour weekly tutorial, which all international medical graduates (whether rostered or not) are expected attend.

Rural hospital

Much of the medical care in this 60-bed hospital is provided by specialists and general practitioners (GPs) from the surrounding community, but the hospital employs 2 medical registrars and one surgical registrar on 3 to 6-month secondments as part of their training scheme. There are no emergency specialists, but one physician from the community serves as the emergency department director on a half-time basis.

The emergency department is staffed during the daytime by 2 interns on 10-week combined rural and emergency rotations, and by one of 4 overseas-trained doctors after hours. The roster for these doctors is structured to include days of semi-unstructured duties which support their preparations for AMC or other examinations. During the first 2 weeks, they are invited to “shadow” other emergency department doctors by way of orientation and training, although much of this shadowing is of interns or other international medical graduates.

As with most emergency departments, this hospital offers a weekly education session. However, on a day-to-day basis, the international medical graduates largely work without any supervision although there are always medical and surgical registrars on-call to assist with more difficult cases.

The level of supervision and training at this hospital could be improved.

Rural hospital

This 33-bed hospital is located in a very small rural community. As with the very smallest of hospitals, it employs no doctors at all, nor does it provide specialist services. Local GPs from the community admit and care for their own patients. For after-hours or unexpected events, these GPs maintain an on-call roster to serve the hospital on a fee-for-service basis.

Conclusion

Generally, the systems and controls for supervision and training of junior medical staff in hospitals improve the larger the hospital. This is due to larger hospitals having the resources to support more robust processes, having a larger supply of supervising practitioners and having access to a larger pool of junior staff from which to recruit.

Further, the smaller and more remote hospitals, which are more dependent upon employing international medical graduates to fill HMO vacancies, are less likely to have formal structures or available specialists to supervise or train them.

Hospitals employing interns are accredited to conduct intern training. The PMCV conducts regular assessments of these hospitals to ensure that their training and supervision are sufficient to warrant accreditation as employers of interns. No such accreditation or other systematic approach exists for international medical graduates registered under section 8 (1) of the Act, although the PMCV is developing draft guidelines for employers of new international medical graduates and Australian-trained registered medical officers.

The needs of Australian practitioners and international medical graduates are quite different and the different registration conditions reflect this. A more robust system is needed to ensure the quality of services provided by practitioners with specific registration.

Such a system would be based on well-defined training, supervision and assessment arrangements appropriate to each registrant. It would recognise a practitioner's current competence and focus hospital training and supervisory resources on areas of required competence.

Practitioners' continued registration would be dependant on progress overseen by the hospital's credentialing committee or similar body, and reviewed more systematically by the MPBV or through the PMCV as its agent.

To support this more systematic approach, the Department of Human Services (DHS) should support hospitals and the MPBV in its implementation and pursue the Victorian Government's 2002 initiative for "new standardised pre-registration assessment of medical skills and clinical knowledge, cross-cultural and communication skills" for categories of specific registration.

The following recommendations are made to address the issues raised in this report.

Recommendations

1. That the MPBV review the administrative processes it uses when applying its guidelines for assessing applicants for registration, including ensuring that adequate evidence is retained on file that all applicants have complied with the MPBV's guidelines.
2. That the MPBV strengthen its requirements for training, supervision and assessment of international medical graduates registered under section 8 (1) of the Medical Practice Act to ensure a more structured training approach to the employment of these practitioners in the public health system.
3. That DHS support the strengthening of systems and requirements for training, supervision and assessment of international medical graduates registered under section 8 (1) of the Act through, in particular:
 - supporting the MPBV to strengthen its guidelines
 - continuing its initiatives in post-graduate medical education
 - working with other states and the Commonwealth Government to develop a national, structured approach to the assessment of international medical graduates.
4. That the MPBV and DHS commend the PMCV guidelines regarding assessment and support for training needs to hospital administrators as a first basis for developing structured training plans, among other things, to promote safe practice.

RESPONSE provided by Secretary, Department of Human Services

The conclusion relating to “Supervision of Hospital Medical Practitioners” suggests that a more robust and systematic approach to the assessment of international medical graduates would ensure the quality of services. The department acknowledges this and has implemented initiatives to improve the assessment capabilities of hospital employers together with additional support in the education and training for international medical graduates (IMGs).

This department funded a consortium to develop an assessment process to ensure a minimum level of safe practice for all international medical graduates seeking employment in the Victorian public hospital system. This process was developed in response to public hospitals’ concern that the Australian Medical Council examination was unsuitable for determining an adequate level of safe practice. The Victorian model was offered to the Federal Government in 2003 for the establishment of a consistent national assessment system for IMGs seeking employment in the Australian health system. The Federal Government has failed to progress this issue.

The department has continued with the implementation of the assessment process, which has now been delivered to public hospitals employing IMGs.

RESPONSE provided by Executive Medical Director, Outer Metropolitan Teaching Hospital

That the audit found that systems were better in larger hospitals than smaller hospitals is a fair comment, but this actually reflects the resources available in terms of dollars and staffing between different types of hospitals. The larger the hospital the more formal the structure will be and the more support mechanisms there will be in place. Small hospitals, rural hospitals and outer metropolitan hospitals are certainly more disadvantaged than the major inner city teaching hospitals. The size of the hospital in fact is an extremely good indicator of what resources are available for the elements required for proper registration, training, support and assessment.

Supervision of doctors is a resource issue with smaller hospitals only having visiting doctors during the day whereas the major hospitals have on site staff at a senior level at all times. Again, the development of a minimum data set required by the MPBV in relation to training and experience and supervision during the year would be useful.

RESPONSE provided by Chief Executive, Regional Teaching Hospital

The determination of qualifications and registrations are not significant issues for our health service.

I would wholeheartedly support the focus on improved support and training for both local and international medical graduates.

While it is appropriate that the Medical Practitioners Board of Victoria and the Postgraduate Medical Council of Victoria establish better guidelines for the supervision and assessment of international medical graduates, this needs to be considered in the context of the ongoing shortage of medical staff in rural Victoria.

RESPONSE provided by Executive Director, Rural Hospital

Our health service sees this as a very important report. In so far as it refers to a 'rural hospital', this is an accurate reflection of our situation. We also agree with the conclusions you reach.

We would like to suggest that:

- 1. the DHS role in recruiting and paying for adequate training of doctors is vital.*
 - 2. rotations of IMGs through metropolitan hospitals as with Australian trained doctors (ATDs) is vital for appropriate training.*
 - 3. it should be recognised that limiting special registration of overseas trained doctors (OTDs) will create a major crisis in staffing of small public emergency departments at nights when only one HMO is needed. Costs will be very significant if this is not addressed as part of the picture.*
 - 4. the current system of OTD references is reviewed and standardised so that it leads to less disputes. This would inevitably come out of a more structured training.*
-



4. Progress in
addressing the
recommendations
of our
performance audit
report, *Community
Dental Services*



4.1 Background

The Victorian Government offers dental services to all school children (up to Year 6), and community dental services to concession card holders and their dependants. Around one-third of the Victorian population is eligible for public dental services.

The Department of Human Services (DHS) has policy and program responsibility for dental public health in Victoria.

Dental Health Services Victoria (DHSV), an independent statutory body, is the lead agency responsible for co-ordinating and managing dental public health services. DHSV manages the Royal Dental Hospital and the School Dental Services, and also contracts with other agencies on behalf of DHS to provide community dental services and pre-school dental services. DHSV is funded through DHS and is both a purchaser and provider of dental public health services.

Our *Community Dental Services* performance audit report was tabled in Parliament in October 2002 and made 15 recommendations addressing 4 main issues:

- service access
- service delivery
- work force issues
- program management.

4.2 Audit conclusions

DHS and DHSV have put in place a number of the recommendations we made in 2002. In particular, they have:

- increased service delivery and implemented a number of initiatives to reduce demand in the longer term
- taken steps to improve efficiency in clinics
- addressed several of the clinical practice and compliance issues in clinics.

DHSV in particular has implemented a number of initiatives to improve and enhance service provision.

Progress has also commenced on a series of plans, starting with the *Oral Health Strategic and Service Plan for Victoria*, developed to provide a comprehensive framework for the dental public health service.

However, progress has been slow in:

- improving waiting list management practices
- developing agency level information on costs and agency level benchmarks.

The increase in funding for community dental services from 2004-05 presents an opportunity to address the worsening access identified in our 2002 report. The challenge now is to provide the modelling, long-term framework and plans to deliver measurable improvement in the delivery of dental public health services, and the oral health of Victorians.

RESPONSE provided by the Secretary, Department of Human Services

In general the report is well balanced, recognising gains made since your earlier report in October 2002, and identifying areas for further improvement. The Department will continue to work with Dental Health Services Victoria to implement these improvements.

4.3 Improving service access

Our 2002 report concluded that:

- The Community Dental Program (CDP) was not providing adequate access for the eligible population. Access was uneven across the regions.
- Targets for average waiting times for restorative care and for dentures had not been met in 4 of the preceding 5 years. Average waiting list times had increased across the State for both restorative care and dentures. The increase was greater in rural than in metropolitan clinics.
- The School Dental Service (SDS) was providing relatively good access for high need clients, but not meeting targets for low-risk students.

4.3.1 Access to community dental care

Since the 2002 audit report, waiting times¹ for access to dental care increased during 2002-03 and 2003-04.

- In December 2001 there were 185 290 people on the waiting list for general care, and a statewide average waiting time of 22 months. At 31 January 2005, there were 193 633 people on the waiting list, and an average waiting time of 31 months.

¹ As we discuss later, the current indicators of 'average waiting time' and 'number of people on the waiting list' have some limitations. However the comparison over time is valid.

- For dentures, in December 2001 there were 25 085 people on the waiting list, with an average waiting time of 24 months. At 31 January 2005, 29 486 were on the waiting list, with an average waiting time 34 months.

In 2004, the Victorian State Budget for 2004-05 provided a 30 per cent increase (\$97.2 million over the next 4 years) to the public dental budget.

Figure 4A shows how these additional funds have been allocated to programs.

FIGURE 4A: ADDITIONAL FUNDS BY PROGRAM

Program Area	(\$ millions)
Community Dental Program	58.0
School Dental Service	12.5
Early childhood oral health program (a)	13.1
Prevention Strategies	3.8
Workforce Strategies	3.1
Oral Health Promotion Strategies	1.2

(a) New program.

Source: Department of Human Services.

A further \$5.5 million has been provided for capital development, which will provide 6 new community dental chairs in 2004-05 and 11 in 2005-06. The new chairs are being distributed across the state, with a preference for clinics co-located with community health services.

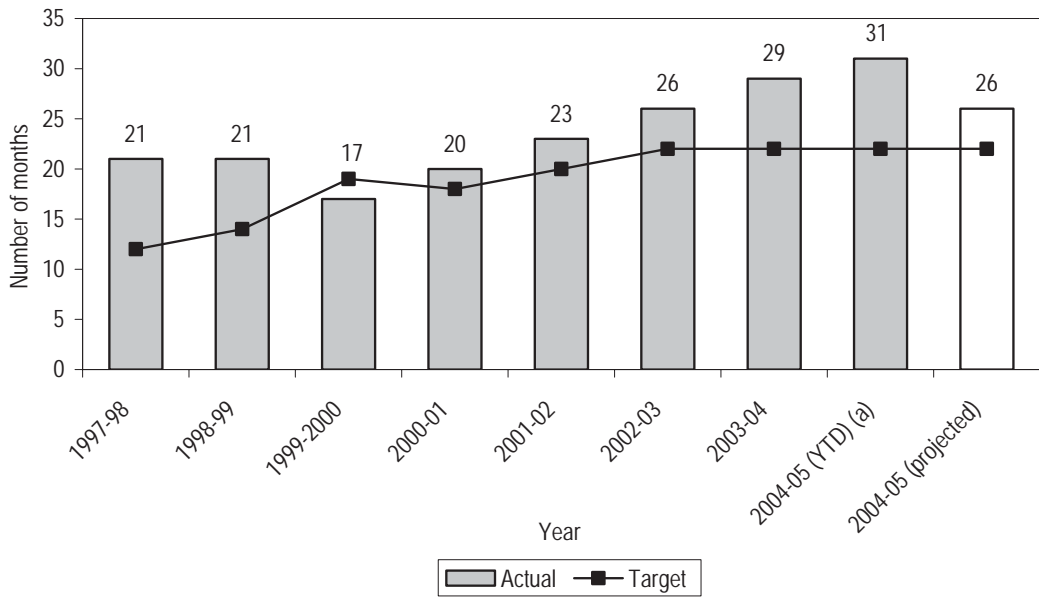
DHSV anticipate that the increased funding allocated in 2004-05 will enable them to contain the growth of waiting times. However, they noted that the 30 per cent overall increase in funding will not lead to 30 per cent more patients being treated. Factors behind this include increased costs of service delivery, and the increasing complexity of care² of patients. In 2000-01 the average number of treatment items provided per person was 5.41. In 2003-04 the average number was 6.12.

Waiting time performance targets for 2004-05 have been set at the same level as targets for 2002-03 and 2003-04. It is not anticipated that these targets will be met.

² DHSV and DHS have noted that the complexity of care of patients, measured by the number of treatment items provided, has increased over the past 4 years. One of the reasons behind this increasing complexity of care is the ageing of the population and the fact that people are keeping heavily restored teeth rather than having their teeth extracted and replaced with a full set of dentures. These teeth require more maintenance and care.

Figures 4B and 4C show performance against targets set for waiting times since 1997-98, year-to-date performance for 2004-05, and projected performance in 2004-05. The projected performance was calculated in October 2004 taking into account funds allocated at that time. DHS and DHSV advise that since that date an additional \$500 000 has been allocated for dentures, and estimated waiting times have not been revised to take this into account.

FIGURE 4B: WAITING TIME FOR GENERAL CARE

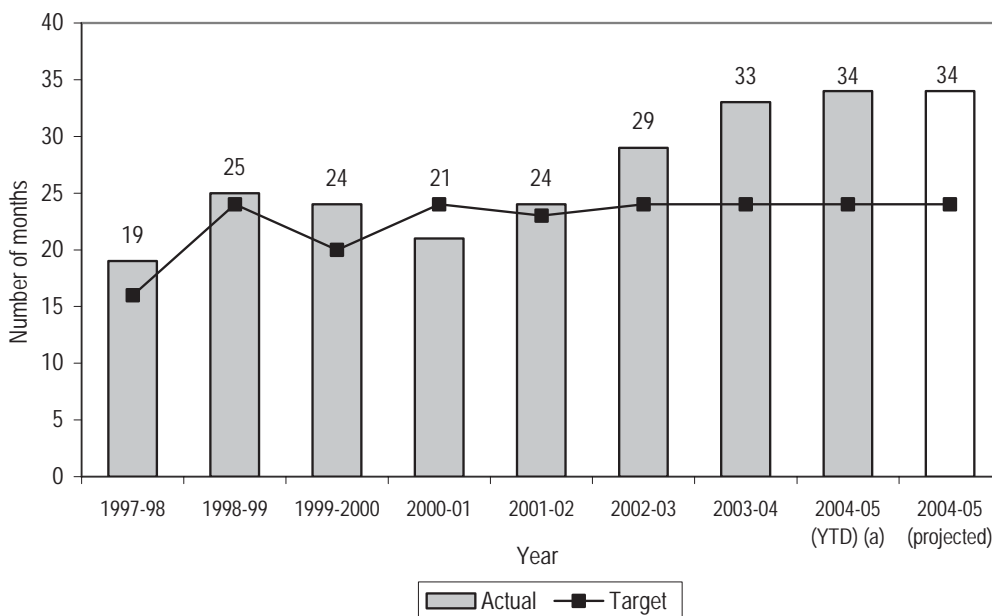


(a) Year to date, to 31 January 2005.

Note: Projected figure for 2004-05, as calculated by DHSV in October 2004.

Source: Dental Health Services Victoria.

FIGURE 4C: WAITING TIME FOR NON-PRIORITY DENTURES



(a) Year to date, to 31 January 2005.

Note: Projected figure for 2004-05 as calculated in October 2005.

Source: Dental Health Services Victoria.

Figure 4C shows waiting times for non-priority dentures. Waiting times for priority dentures are considerably lower than for non-priority dentures and are shown in Figure 4D. Around 50 per cent of patients are assessed by clinics as having “priority” needs for dentures³. These patients are usually given the next available appointment, with a target waiting time of 3 months.

FIGURE 4D: WAITING TIME FOR PRIORITY DENTURES

Year	1999-2000	2000-01	2001-02	2002-03	2003-04
Waiting time (months)	10.5	3.78	2.31	1.51	2.25

Source: Department of Human Services.

Allocation of additional funding to agencies is based on a ‘hot spot’ approach which provides additional funds to clinics with the longest waiting times for care and offers these regions priority access to resources and assistance in developing localised solutions. The regional allocation of funds, and waiting times as at October 2004, are outlined at Figure 4E.

³ This may be, because for example, they have missing front teeth.

FIGURE 4E: REGIONS – WAITING TIMES AND BUDGET INCREASE 2004-05

Region	General care waiting time (Oct 04)	Denture waiting time (Oct 04)	Budget 2004-05	Budget increase over 2003-04	Additional people seen (a) – anticipated
	(months)	(months)	(\$)	(%)	(No.)
Barwon	42.70	43.95	4 992 621	60	2 984
Grampians	26.54	29.09	3 197 352	57	1 938
Loddon Mallee	31.86	18.59	3 259 018	53	1 976
Hume	22.74	41.56	2 202 847	42	1 335
Gippsland	43.49	28.72	2 874 205	31	1 742
N-W Metro	23.81	33.27	15 484 310	33	9 386
Eastern Metro	26.92	48.91	5 643 068	64	3 421
Southern Metro	32.49	46.93	10 258 248	26	6 218
Total/average	30.75	35.18	(b) 48 263 768	41	29 000

(a) "People seen" may include a number of procedures/appointments for a single individual.

(b) Includes other initiatives e.g. travelling dental team.

Source: Victorian Auditor General's Office, from data provided by DHS and DHSV.

DHSV has modelled the impact of additional funding on access for 2004-05. The priority has been identifying areas of immediate need and distributing funds to these areas.

To date, neither DHS nor DHSV have modelled the impact of the additional funding on access beyond 2004-05. DHS commissioned modelling work in 2003-04 which gave long term projections of demand at clinic level. However, this work has not yet been re-visited since then. The likely impact of the additional funding on waiting times, and the capacity of the system to meet projected demand has not been modelled beyond the end of this financial year.

DHS and DHSV are also working to reduce long-term demand by emphasising prevention programs and extending the service to younger people. Around \$3.8 million in funding has been provided for prevention programs, including extension of fluoridation to towns of over 5 000 people where there is community support. Around \$15.8 million has been allocated to a new early childhood oral health program. This program commenced on 1 July 2004 and will see an additional 77 000 preschool children over 4 years.

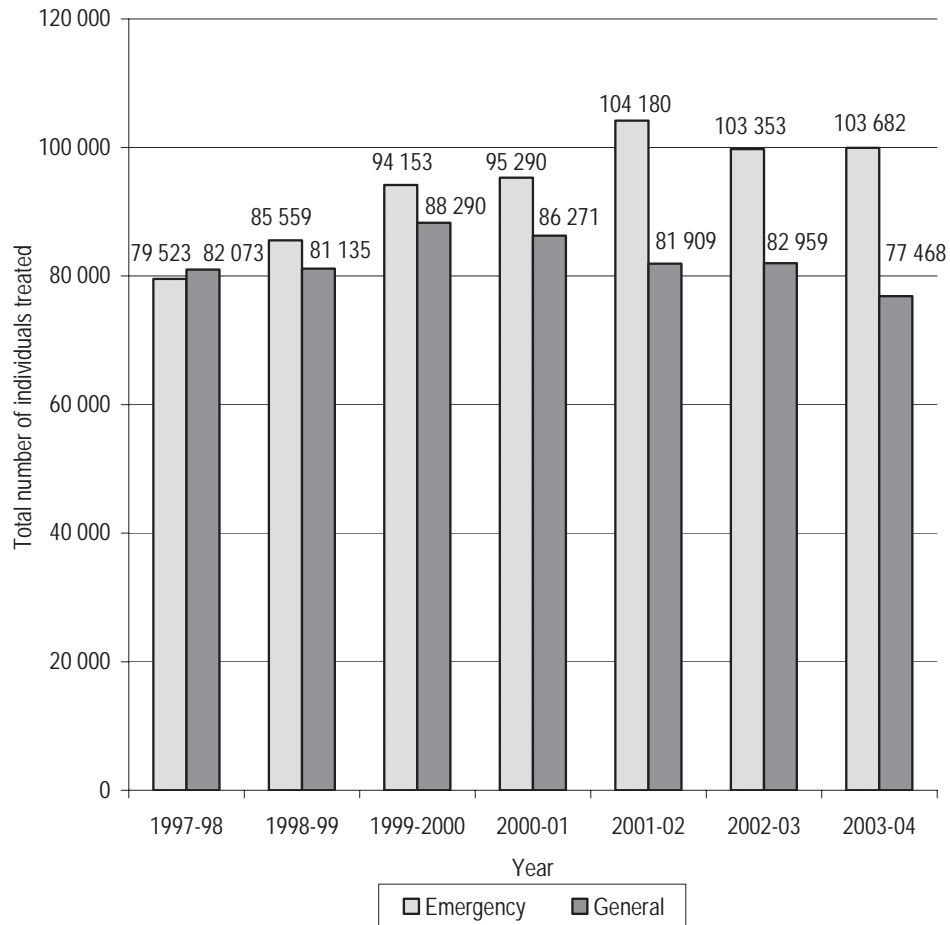
4.3.2 Waiting list management

Currently, each community dental agency maintains its own waiting list, and patients must put their name down for care. If a patient identifies that their condition is an “emergency” they are assessed within 24 hours. If they are assessed as requiring urgent care, they are given the first available appointment (they may also go on the waiting list for any non-emergency treatment required).

Across the state there is significant variation in waiting times, and the current statewide average waiting time masks some extremely long waits. Clinic level data for January 2005 (which shows a statewide average waiting time for restorative care of 30.91 months, and 34.26 months for dentures) shows that the *maximum* waiting time for restorative care is 69.65 months (5 years 9 months) and for dentures is 67.35 months (5 years 7 months).

In 2002, we noted that the ratio of emergency treatments to general dental treatments reflected an increasing use of unplanned (emergency) care. During the 2 years since our report, there has been a steady increase in the number of patients given emergency care, while the number of patients taken off the waiting list has decreased. As a result, the ratio of unplanned care to general treatment provided has increased. This trend is illustrated below in Figure 4F.

FIGURE 4F: NUMBER OF PATIENTS RECEIVING UNPLANNED AND GENERAL CARE, 1997-98 TO 2003-04



Source: Dental Health Services Victoria.

High use of emergency care reduces resources available for taking patients off the waiting list for planned care. There is also a risk that a patient who presents as an “emergency” will be treated ahead of others on the waiting list who may have more serious dental health needs. In order to promote consistency in selection for unplanned care across clinics, DHSV is implementing an emergency triage system. This system was piloted in 2004, and DHSV expects full implementation by the end of June 2005.

The current decentralised approach to waiting list management means that information about demand is not accurate:

- Because waiting times vary at clinics, some patients put their name down at a number of clinics. Clinics have no way of knowing how many patients on their list may also have their name down elsewhere. DHS and DHSV believe that overall, less than 5 per cent of patients are on multiple lists, but that this is likely to increase with lengthening waiting times.
- Some clinics review their waiting lists regularly, and check if people are still waiting for service. However, some wait until people are offered service to remove them from the list. As a result, the number of people reported as being on the waiting list at different clinics is not comparable.

As well as reporting the number of people on their waiting list, clinics report on “waiting time” which is the time since the longest waiting patient was added to the list. However this figure is not an accurate indicator of how long a patient who puts their name down *today* is likely to wait for service. If demand at a clinic is growing faster than patients on a list are treated, then the wait experienced by patients putting their name on a list today could be significantly longer. Currently, there is no assessment or reporting on this estimate.

Since our 2002 report, DHSV has undertaken a survey of waiting list management practices across a number of community dental agencies and proposed a strategy to improve waiting list management and provide a common approach across the state. One element of the DSHV proposal, an emergency triage system, has been piloted and will be fully implemented by June 2005, waiting list audits have been conducted on agencies with the longest waiting times, and DHSV are supporting agency initiatives to cull lists.

DHS and DHSV are yet to reach agreement on other elements, including the efficiency of a statewide cull of waiting lists and whether there should be other changes to waiting list management practises. DHSV has proposed the consolidation of the 60 separate waiting lists across the state into a central waiting list, as well as a prioritisation system that would categorise non-emergency patients into high/moderate/low need. However, DHS believes that further research and cost-benefit analysis would be required before implementing these changes.

4.3.3 School Dental Service

In 2002 we reported that the School Dental Service was failing to meet targets for provision of dental care for low risk children and cycle times⁴ were increasing.

Cycle times continued to increase in the 2 years following our report. At the end of 2003-04, the average cycle time was 33.8 months statewide.

During 2004-05, average cycle times have reduced and, at the end of December 2004, the average cycle time was 31.2 months. On current trends DHSV anticipate it will be 29.5 months at the end of June 2005.

The target of 12-month recall for children most at risk is being met. A cycle time of 24 months is considered ideal for all other children; however, the target set for 2004- 2005 is 28 months. DHS anticipate that the target for 2005-06 will be 24 months.

4.3.4 Conclusion - Improving service access

It is too early to tell whether the increased funding provided for service delivery will significantly improve waiting times for community dental services. Year-to-date performance does not fully reflect the impact of the increased funding because of the time required to increase service delivery.

While DHS and DHSV anticipate that Community Dental Program (adult) waiting times will reduce, they believe that it is unlikely that the waiting time targets for 2004-05 will be met.

The continuing high ratio of unplanned to planned care, and the increased care needs of some patients who have been waiting for long periods for care mean that significantly reducing waiting times will be challenging.

The initial distribution of funds to address areas of immediate need has been a necessary short-term response, needed because there had been no long-term projections of demand at clinic level. However, allocating additional funds on the basis of current waiting times is not a sound basis in the long term. The 'hot spot' strategy needs to be replaced by a comprehensive analysis of current and future demand, and resources allocated on that basis.

The current approach to waiting list management means that it is not possible to accurately know how many people are waiting for treatment in Victoria and how long they will wait. It is also not possible to know if the current supply of services is matching demand.

⁴ Cycle time is the length of time before the School Dental Service recalls a child for general dental care.

There are inequities in current waiting list management practices. The implementation of a common emergency triage protocol will reduce "queue jumping" by people who present as an emergency while others who may have greater clinical need wait for planned care. However, the inequity of patients waiting for long periods at their local clinic while other clinics in the region could offer them quicker service needs to be addressed.

Recommendations

- 1. In collaboration with DHSV, DHS needs to lead the development of comprehensive modelling work taking into account current demand, growth rates and impact of additional funds by region. This work should be aligned with other strategic planning projects to ensure the most efficient and effective allocation of additional funds.**
- 2. DHS and DHSV need to collaborate on the implementation of a waiting list strategy as a priority. This needs to include developing an accurate picture of current demand on waiting lists (including the number of people on the list, the time they have been on the list and projected waiting times based on current demand and supply). The strategy also needs to incorporate measures to manage excessive waiting times.**

RESPONSE provided by the Secretary, Department of Human Services

Recommendations agreed.

DHS is to continue the modelling work undertaken by contract in 2003-04 that gives long term projections of demand at clinic level. However, it should be recognised that modelling is not an exact science given the many supply and demand variables involved.

Considerable efforts are being made to manage waiting lists with positive results. While the fuller impact of the additional \$97.2 million provided in the 2004-05 budget over the next 4 years will be seen by July 2005, progress to date includes:

- An 8% (7 244) increase in the number of people treated in the Community Dental Program between July and December 2004 compared to the same period in 2003 (100 731 people treated compared to 93 487). This will equate to an additional 29 000 people being treated in 2004-05 compared to 2003-04.*

RESPONSE provided by the Secretary, Department of Human Services - continued

- 15 300 less people waiting for service in January 2005 compared to July 2004, through a combination of more people treated and waiting list audits.
- Stabilisation of waiting times after increases of 3 months every year for the last 3 years. Non-priority denture waiting times have decreased over each of the last 4 months and were a month lower in January 2005 (34 months) compared to October 2004 (35 months).

It is also important to recognise that people with urgent needs receive care within clinically appropriate timeframes. Emergency needs are assessed within 24 hours and people in urgent need of dentures are treated within 3 months.

4.4 Improving the efficiency of service delivery

Our 2002 report concluded that:

- Efficiency in clinics varied widely, with the underlying reasons for variations in performance between clinics not well understood, and a lack of a system-level approach.
- Infection control and health and safety performance was uneven across clinics. Record keeping standards were inconsistent, particularly regarding patient consent forms and complaint handling.
- The condition of some clinics (particularly the mobile dental vans), and equipment was poor. An audit of equipment (other than that funded through minor works) should be conducted to enable the development of an equipment replacement strategy for the entire system.

4.4.1 Clinic efficiency

In our 2002 report, we noted a wide variation in the number of individuals treated, across chairs and across regions. We recommended that DHSV undertake a review of clinic efficiency, to find out why performance varied, and to develop strategies to make service delivery more efficient. Our report recommended that this commence with improved monitoring and benchmarking of dental clinics.

DHSV advises that limited progress has been made in identifying benchmarks that would enable comparisons between clinics. DHSV has developed processes for measuring clinic efficiency in terms of chair management, with agency funding allocated on a chair utilisation model. However, benchmarking work that commenced under the Dental Funding Reform Project is yet to be completed.

A number of initiatives implemented since 2002 are likely to enhance clinic efficiency. These include roll-out of a new electronic patient records management system (EXACT). Current targets are to complete the roll-out to all community dental clinics within 13 months, and to the School Dental Service within 22 months.

4.4.2 Clinical practice and compliance

In 2003, DHSV completed its first quality accreditation under the Australian Council on Health Care Standards Equip3 framework. DHSV has also developed a compliance framework so it can identify and meet its obligations in regard to laws, regulations, contracts, industry standards and internal policy.

DHSV uses the Funding and Service Agreements (FASA) with all agencies to detail compliance requirements for infection control and safety standards. DHSV uses self-assessment tools in infection control for clinical practice, instrument and equipment sterilisation and infection control.

During 2003-04, DHSV undertook 8 clinical audits – 4 rural, 4 metropolitan. There are plans for another six in 2004-05. The 2003-04 clinical audits showed consistently high levels of compliance across all aspects of clinical practice with the exception of documenting client consent and maintaining up-to-date client histories. The roll-out of the EXACT system is expected to improve performance in this area.

4.4.3 Equipment management

We reported in 2002 that a number of client clinics had criticised the DHSV workshops for slow response times and excessive cost. DHSV underwent a major re-organisation during 2002-03, which included the separation of workshop activities into a separately registered business unit, Dental Logistics. The changes were expected to produce better outcomes for service and equipment purchasing and for equipment repair and maintenance.

The re-structure has been accompanied by a number of initiatives:

- Dental Logistics has introduced a computerised maintenance management system which has allowed it to achieve efficiencies through bundling service callouts by location (reducing the costs of multiple call outs) , and prioritising urgent work.
- The distribution of “self-help” manuals has provided advice to agencies on how to manage minor repairs in-house.
- The introduction of a new capital prioritisation model involving all agencies completing a standardised form on an annual basis. This allows for streamlining of requests on an equitable basis. Dental Logistics reports that the allocation process is less haphazard and the waiting time from request to delivery has been shortened.

DHSV plan to review the effectiveness of the new Dental Logistics unit during 2004-05, and to report by December 2005.

DHSV undertook an equipment audit in 2002-03 as a pre-cursor to the introduction of an equipment replacement strategy. The strategy has been completed, and identifies the desirable replacement timetable to maintain equipment into the future.

The future of the mobile dental clinics remains an issue. Mobile clinics can provide access in remote areas, but older vans do not provide a good clinical environment and have been identified as a significant source of work dissatisfaction for dental therapists. Fixed clinics provide better facilities (reception, waiting rooms and toilets), integration with other public dental and community health services, certainty of location, and an enhanced clinical environment (peer support, infection control and clinical amenity).

At the time of our 2002 audit, there were 37 mobile dental vans in use, and older vans were being progressively decommissioned. During 2004-05, \$882 000 in infrastructure funding has been provided for medical equipment and infrastructure. This will enable the purchase of 2 new 2-chair vans. However there is currently no plan determining the desired number, standard and location of mobile clinics.

4.4.4 Conclusion - Improving efficiency of service delivery

A number of initiatives to improve the efficiency of service delivery have been undertaken, however the benchmarking work commenced by DHSV in 2002 has yet to be completed.

The compliance framework depends in part on self-reporting and a small number of annual audits. Training and support for staff in self-reporting, and a wider audit program to cover all community dental clinics will help keep this on track.

Some of the changes implemented by Dental Logistics (for example the distribution of self-help manuals to allow clinics to carry out minor maintenance) make good business sense for DHSV. However they need to be monitored to see whether genuine efficiencies are being achieved and the changes are benefiting both Dental Logistics and clinics.

Current progress toward decommissioning or replacing older mobile clinics is slow. This is a significant investment, and a strategic approach is needed. The development of the Dental Capital Plan (which we discuss in the next section of this report) needs to consider this issue.

Recommendations

3. **DHSV should complete the work commenced on benchmarking.**
4. **DHSV's review of the effectiveness of Dental Logistics should consider agency satisfaction with changed service arrangements.**
5. **The Dental Capital Plan should include an analysis of the desired configuration of fixed and mobile clinics, and plans to decommission any vans identified as not meeting clinical standards and service requirements.**

RESPONSE provided by the Secretary, Department of Human Services

Recommendations agreed.

4.5 Work force planning

Our 2002 report concluded that:

- Immediate and long-term initiatives were needed to address current work force shortages and future shortages generated by growing demand. Targeted initiatives were needed to address particular shortages in the public sector and in rural and regional Victoria.
- A workforce database was needed to enable accurate and ongoing monitoring of the oral health workforce for the school dental service and the community dental program.
- The role of allied dental professionals could be expanded to enable them to provide some services traditionally provided by dentists.

4.5.1 Work force initiatives

In 2002 we reported substantial vacancy levels in the Community Dental Program and School Dental Service, particularly in rural areas. National and state analyses showed that the situation was likely to worsen, with high and growing demand predicted to 2010.

Since 2002, there has been an increase in the number of clinicians employed in the Community Dental Program and School Dental Service, however the number of positions required to service demand has increased at a faster rate. Thus, the overall vacancy rate has increased.

Figure 4G shows dentists required and vacancy rates in August 2002, December 2002, June 2004 and December 2004. Vacancy rates tend to increase at the end of each calendar year.

Comparisons between August 2002 and June 2004, and December 2002 and December 2004 show marginal reductions in the overall vacancy rate. By December 2004, with an increase in the number of positions needed, and a reduction in clinicians employed, the vacancy rate was 20.2 per cent.

FIGURE 4G: COMMUNITY DENTAL PROGRAM AND SCHOOL DENTAL SERVICE CLINICIAN VACANCIES 2002 TO 2005

	Dentists required	Employed	Vacancies	Vacancy
	(no.)	(no.)	(FTE)	Per cent
Rural	61.3	43.3	18	29.4
Metro	121.5	106.2	15.3	12.6
Total August 2002	182.8	149.5	33.3	18.2
Rural	70.8	43.9	26.9	38.1
Metro	134.0	116.6	17.4	13.0
Total December 2002	204.8	160.4	44.4	21.7
Rural	73.0	44.5	28.5	39.0
Metro	140.1	136.9	3.2	2.3
Total June 2004	213.1	181.4	31.8	14.9
Rural	71.8	41.1	30.7	42.8
Metro	142.9	130.3	12.6	8.8
Total December 2004	214.7	171.4	43.3	20.2

Source: Department of Human Services.

Generally, it appears that the situation in metropolitan clinics has marginally improved between 2002 and 2004. However, the rural vacancy rate has worsened from 29 per cent in August 2002 to 39 per cent in June 2004, and 42.8 per cent in December 2004.

In order to address the shortage in rural areas, DHSV has deployed travelling dental teams made up of a dentist, a prosthetist, a dental therapist and 2 assistants to travel to understaffed rural agencies. Visits to Bairnsdale, Sale, the Latrobe Valley, Warrnambool, Horsham and Wangaratta are planned for 2005 to provide treatment where there are limited numbers of public dentists and strong unmet demand for services.

There are fewer dental therapists employed in December 2004 (81) than there were in August 2002 (86). Rural clinics have a vacancy rate of 36 per cent. As with clinicians, more positions have been needed to service growing demand. In addition, prior to 2002, dental therapists were only able to work in public dental services. From 2002 dental therapists have also been employed in the private sector, creating increased competition for qualified staff.

FIGURE 4H: SCHOOL DENTAL SERVICE – DENTAL THERAPIST VACANCIES

	Therapists required	Employed	Vacancies	Vacancy
	(no.)	(no.)	(FTE)	(%)
Rural	45.5	32.8	12.7	27.9
Metro	72.5	54.1	18.4	25.4
Total August 2002	118.0	86.9	31.1	26.4
Rural	44.4	28.3	16.1	36.3
Metro	67.3	52.7	14.6	21.7
Total Feb 2005	111.6	81.0	30.6	27.4

Source: Department of Human Services.

From 2005, the 2 year diploma for dental therapists will become a 3 year degree course. This will potentially worsen the situation, by creating a gap year in 2007 when there are no graduating students. Strategies are being discussed to manage this impact.

The Victorian Public Dental Workforce Project has identified reasons for the difficulties in recruitment and retention, particularly in the public sector, and identified broad strategies with 2, 5 and 10 year targets to improve this, including:

- promoting the goals and directions of public dental service in Victoria
- career paths and professional development opportunities, including mentoring
- examination of remuneration packages
- increasing re-entry to the labour force.

An additional \$3.1m over 4 years has been allocated to address dental workforce shortages and implementation of the immediate strategies is expected by March 2005.

DHSV has developed a recruitment and retention plan for dentists, dental therapists and dental assistants. The plan identifies attraction and retention barriers, with a plan of action to address each barrier.

DHSV also conducts regular recruiting campaigns to identify potential applicants with suitable qualifications. The graduating classes from the University of Melbourne and RMIT are regularly contacted about working in the public sector, particularly rural areas. DHSV and DHS also work to increase recruitment of dentists from overseas, either through encouraging overseas students who train here to remain, by attracting overseas-trained dentists and extending automatic registration (for public dental provision) for additional countries.

Activities to improve recruitment and retention in rural areas include scholarships and internships to encourage students to experience work in rural public clinics; mentoring programs for young graduates placed in rural practices; and linking in to local government plans to attract and retain professionals in their area.

Rural allowances for clinicians in public clinics have been increased to match the overall remuneration levels paid in other states.

4.5.2 Work force information

DHSV collates a return on work force vacancies in community dental agencies and the school dental service that is provided to DHS quarterly. Data is collected on the number of dentists, dental therapists and prosthetists required and employed, plus vacancy rates.

To date, a comprehensive work force database has not been developed. Such a database would include identifying critical roles and provide information enabling analysis of the work force in terms of experience, capability, vacancy rates, staff mix and duration of vacancies⁵. A comprehensive work force database would also assist with analysis of the success of work force strategies, by building information on how long employees remain, where employees came from, and the destinations that employees go to or their reasons for leaving.

⁵ Victorian Auditor-General's Office, 2004, *Meeting our future Victorian Public Service workforce needs*, Government Printer, Melbourne, p39.

4.5.3 Expanding the role of allied dental professionals

Some progress has been made in expanding the role and scope of activities that can be undertaken by dental therapists. In late 2002, the Dental Practice Board of Victoria developed a Code of Practice for the practice of dentistry by dental hygienists and dental therapists after consultations with practitioners, dental professional bodies and educational institutions. The Code allows dental therapists, on prescription from a practising dentist, to treat patients aged between 19 and 25, an increase from the previous age limit of 18. In addition:

- therapists and hygienists can work in areas where they have training and are assessed as competent – previously they were restricted to a relatively narrow list of tasks they could undertake
- a trial to use dental hygienists in nursing homes has commenced.

In 2003-04, DHSV commissioned a review of work structure and satisfaction issues for dental therapists. The key factors identified were:

- pay
- decommissioning of mobile vans
- improving professional standing
- implementing the 1:1 ratio of dental assistants to dental therapists in the School Dental Service.

4.5.4 Conclusion - Work force planning

The increase in service delivery made possible by the funding increase can only be delivered if work force shortages are addressed. Workforce shortages are a national problem and the solutions are not entirely in DHS or DHSV's control.

To date, little progress has been made in addressing workforce shortages in rural Victoria. The programs being implemented to encourage new graduates to consider rural areas and to offer them support and mentoring programs are a start.

Many initiatives have commenced to address the work force shortage, and each may make a contribution toward solving the problem. However, they need to be monitored for impact and cost-effectiveness.

Currently, information on work force is poor, and the work done to date is little more than reporting on vacancies. Better information will help DHS and DHSV to measure the success of their responses to the work force shortage and to identify additional opportunities.

Recommendations

6. **DHSV should develop a more complete dental health work force database. In addition to the information currently collected, they should include information on the profile of the current work force, how long employees remain, where employees came from, the destinations that employees go to and their reasons for leaving.**
7. **DHS should monitor and report on the effectiveness of implementation of their 2, 5 and 10 year public dental work force strategies.**

RESPONSE provided by the Secretary, Department of Human Services

Recommendations agreed.

4.6 Program management

Our 2002 report concluded that program management required improvement. In particular:

- The strategic direction for dental public health needed to be revisited to ensure that it was appropriate to program objectives.
- There were divergent understandings and expectations of roles and responsibilities between DHS and DHSV for both policy and operational areas.
- The relative cost of service delivery through DHSV and non-DHSV clinics was not known. There was not sufficient data on the costs of service provision to make fully informed decisions on resource allocation.
- Performance reporting was adequate but focused on outputs (numbers of services delivered) rather than outcomes (the impacts of services against the program objectives for oral health in Victoria) or quality of care delivered.

4.6.1 Strategic planning

At the time of our report in 2002, the state strategy for dental health in Victoria was 7 years old, and had been developed prior to the establishment of DHSV. DHSV had strategic plans, however these only related to its own services.

Since our report, DHS has reviewed priorities for oral health, and articulated them in the *Oral Health Strategy 2004-08*. This strategy sets down the policy framework against which DHSV is developing the *Oral Health Strategic Plan and Service Plan for Victoria*.

After extensive consultations, the first stage of the *Oral Health Strategic Plan and Service Plan: Strategic Directions 2005-2010* is in a final draft form.

The Capital Plan, which will detail strategic, service and infrastructure planning, is currently scheduled for completion in October 2005. DHS and DHSV will collaborate on this plan.

DHS is also developing the *Victorian Oral Health Promotion Strategy 2005-10*, due for release in October 2005.

4.6.2 Roles and responsibilities

The *Oral Health Strategic Plan and Service Plan: Strategic Directions 2005 – 2010* includes a specific section on the 10 key leadership areas for DHSV, along with its direct service delivery responsibilities.

However, DHSV and DHS advise that there are still areas where the division of responsibilities between the 2 bodies is unclear, and where working arrangements could be improved. DHS has committed resources and in conjunction with DHSV will undertake a collaborative review of respective roles and responsibilities. The review will take place over the next 6 months.

Other steps, including the re-organisation of DHSV, with the new Dental Logistics unit and the creation of a single clinical unit and a single Health Purchasing and Provider Relations unit, have helped improve client and supplier understanding of their respective roles.

4.6.3 Understanding the costs of service delivery

Our 2002 report recommended that a review of the funding formula be undertaken to ensure that clinics were adequately funded to meet the costs of service delivery. At that time, clinics were funded on a system where each item of service was multiplied by a funding rate based on the Commonwealth Department of Veteran's Affairs Local Dental Officer (DVA LDO) rate unit price. This price, along with population statistics and data on a clinic's productivity is used to determine funding paid by DHSV to a clinic.

Since 2002, a number of projects have considered aspects of the cost of service delivery:

- The dental funding reform project commenced in February 2003. The project determined that the most significant issues were salary assumptions, laboratory costs, and management overheads. These three areas have been addressed in the 2004-05 funding formula. The Victorian Healthcare Association (VHA) has expressed satisfaction with the new formula.
- DHS has developed a specific funding formula for the Early Childhood Oral Health Program (ECOHP). The ECOHP funding formula for 2004-05 recognises the different costs of provision by dental therapists and dentists. DHS is considering extending this approach to the other components of the Community Dental Program.
- The DHS Primary Health Funding Approach Costing Study, due for public release early in 2005, investigated the factors that affect the overhead costs of primary health agencies, including those that manage community dental programs. The study found no evidence of cross-subsidisation of the dental program by other program funding and concluded that the dental program was covering its costs through the output funding formula and direct grants for equipment. The report also commented that agencies do not currently maintain suitable data to reliably inform or regularly update unit prices for the costs of service delivery, including dental services.

However, overall, there is still no effective means of determining the unit costs of service delivery.

4.6.4 Accountability and monitoring

Our 2002 report found that information reported, both externally and internally, was substantially focussed on outputs, with a lesser degree of reporting on outcomes. It also found that some of the reporting from DHSV to DHS focussed inappropriately on operational issues (for example, the number of library requests). The audit recommended that reporting required should inform DHS' policy development role, and enable it to monitor the effectiveness and efficiency of DHSV's management of the service system.

In 2004-05, DHS implemented reporting by health services against targets agreed in the Statement of Priorities (a high-level agreement between the minister and the chair of the Health Service Board). Reporting by DHSV under the Statement of Priorities includes information on delivery of key projects and on access and activity targets.

Public reporting of data on community dental waiting times was removed from the Dental Health Services Victoria website in August 2003. While information on Statewide performance was available annually in the Budget Estimates reports, information on performance at clinic level was not widely available.

DHS advises that the withdrawal of the information from the DHSV website happened because they planned to include the information in the quarterly Hospital Services Report. In April 2005, DHS launched "Your Hospitals" a quarterly performance report. The revised report includes clinic level data.

4.6.5 Conclusion - Program management

Overall, there has been considerable development in strategic planning since our 2002 report. DHS and DHSV have commenced a substantial strategic and service planning task. This will be critical if they are to deliver the service increases made possible through the increased funding. The work planned for 2005, including development of a detailed service plan and asset management strategy, needs to be a priority.

The improved strategic planning process has begun the process of clarifying the roles and responsibilities of DHS and DHSV. DHS's commitment to working with DSHV to review arrangements during 2005 should also drive improvement.

Little progress has been made in improving the understanding of the costs of service delivery for dental health. This will be essential if additional funding is to be allocated wisely in the future.

The introduction of reporting against the Statement of Priorities will enhance reporting from DHSV to DHS, and enable reporting to focus on key performance issues.

The absence of easily accessible publicly reported performance data from August 2003 to April 2005 is a concern. While state level information was reported annually, as previously discussed, this state average figure masks significant outlier waiting times. Key performance information should not be withdrawn from one source without a strategy in place to make it available from another.

Recommendations

8. **DHS needs to undertake work to better understand the costs of service delivery and develop a funding formula based on this information.**
9. **DHS should ensure that when changes to reporting of performance information are implemented, there is a transition strategy to ensure continuity of reporting.**

RESPONSE provided by the Secretary, Department of Human Services

Recommendation 8 agreed with qualification. The funding formula assumptions will continue to be monitored with annual revisions as appropriate. As the report recognises, a number of recent projects have considered aspects of the cost of service delivery. The accuracy of agency costing data will improve as community health services introduce more comprehensive systems to record and attribute costs.

Recommendation 9 agreed.



5. Implementation of the Telecommunications Purchasing and Management Strategy (TPAMS)



5.1 Audit conclusion

In July 2002, as part of its *'eGovernment vision - Putting People at the Centre'* initiative, the government launched the Telecommunications Purchasing and Management Strategy (TPAMS). The strategy establishes a framework for the whole-of-government procurement and management of telecommunications services into the future. It involves 4 projects that aim to improve the accessibility, quality and cost of telecommunication services across the Victorian public sector.

Our examination of the implementation of TPAMS concludes that, overall, this initiative was effectively planned and managed. Although minor project delays and project cost revisions were experienced, the project is still on track to meet the June 2006 deadline and is within budget. However, enhancements to project cost and milestone reporting need to be considered.

The program's project governance and management by the Department of Infrastructure (DOI) and its Chief Technology Office (CTO) is robust. However, the role of the Office of the Chief Information Officer (within the Department of Premier and Cabinet) needs to be reviewed and clarified in relation to monitoring whole-of-government information technology projects.

The telecommunications contract procurement process was assessed as fair and followed due process and complied with Victorian Government Purchasing Board guidelines.

It is still too early for us to conclude that all TPAMS program expected benefits and cost savings will be achieved. However, early indications are that lower telecommunication prices were negotiated and regional areas may have enhanced telecommunications access. The project team also indicated that the original expected savings, of \$73 million over 5 years, are likely to be exceeded.

The government's intention is that the savings achieved from the project will be re-invested in additional bandwidth or telecommunication services, and therefore provide a greatly improved service. However, this will be achieved at a cost of \$55.2 million.

Although the TPAMS program risks are adequately managed, as the TPAMS program progresses risks associated with government department and agency take up of telecommunication services and the chief technology office's ability to manage multi-supplier and user telecommunication services, will need to be closely managed.

RESPONSE provided by Secretary, Department of Infrastructure

The Department of Infrastructure administers the Telecommunications Purchasing and Management Strategy (TPAMS) which establishes a framework for the whole-of-government procurement and management of telecommunications services.

The Auditor-General's report acknowledges the importance of this strategy which, through a number of projects, aims to improve the accessibility, quality and cost of telecommunication services across the Victorian public sector.

The report presents 4 key recommendations. The department accepts and is supportive of the report's recommendations.

5.2 Background

The Victorian government is the largest single purchaser of voice, data and mobile telephony telecommunications in Victoria, spending about \$178 million a year.

In March 2002, the government launched its 'eGovernment vision - Putting People at the Centre' policy. In July 2002, as part of this policy, it launched the Telecommunications Purchasing and Management Strategy (TPAMS). The strategy establishes a framework for the whole-of-government procurement and management of telecommunications services into the future.

The objectives of TPAMS are to improve:

- competition, to lower the cost of telecommunications to the government and businesses and to provide access to the latest technology
- connectivity between agencies
- convergence, to provide government data, voice and video services through a single network.

TPAMS aims to replace the current Victorian government telecommunications framework, which consists of:

- the StateNet telephone facilities management contract, which services 23 000 users in the Melbourne central activities district and at several regional locations
- the VicOne data services contract, which extends to some 4 500 sites across the state
- the Telecommunications Purchasing Strategy, which involves the use of 4 telecommunication service panels.

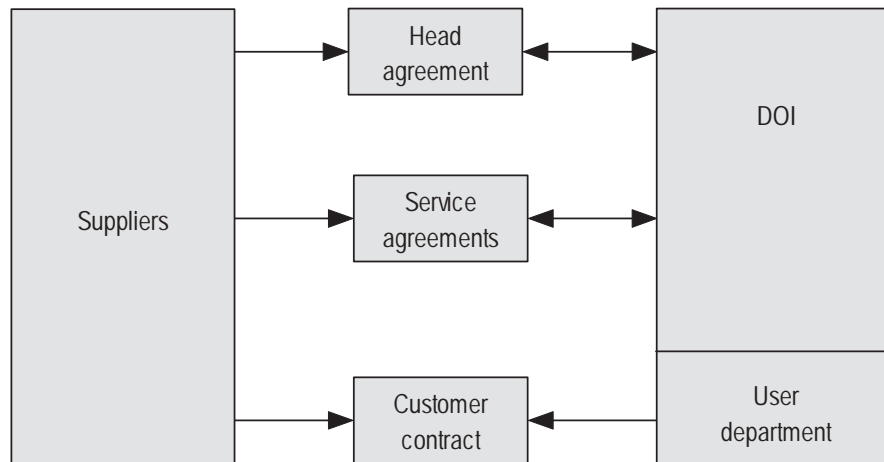
Until October 2003, TPAMS was managed by the executive director, Multimedia Victoria, in the Department of Infrastructure (DOI). From that date, the Chief Technology Office of DOI assumed responsibility for managing the implementation of TPAMS and the executive director, Multimedia Victoria, assumed the role of project sponsor.

Strategy implementation is expected to cost \$55.2 million over 4 years, and result in savings to departments and agencies in excess of \$73 million over 5 years. Savings are expected to result from reduced prices (call costs) as a result of increased competition between suppliers.

At the date of preparing this report, all procurement projects under the strategy had started. The projects are:

- Victorian Office Telephony Services (VOTS)
- Telecommunications Carriage Services (TCS) (for data, voice and mobile services)
- Local Area Network (LAN) Transport Upgrades
- Network Operations Support (NOS)

Under the strategy, DOI has a head agreement with each supplier that establishes the broad framework and cost structures under which services are to be provided to government agencies, and a service agreement that outlines the technical specifications which are to be met by the supplier. The departments and agency users of the telecommunication service then have customer contracts that specify the services to be provided and the associated cost for these services. Figure 5A illustrates the telecommunications procurement framework.

FIGURE 5A: TELECOMMUNICATIONS PROCUREMENT FRAMEWORK

Our audit examined how well the implementation of TPAMS was being managed. In doing so, we assessed whether:

- a robust governance structure was established over the project
- the contract procurement process was well conducted, fair and competitive
- the project was on time and within budget
- the expected savings and other benefits from TPAMS were realised
- the project risks were adequately managed.

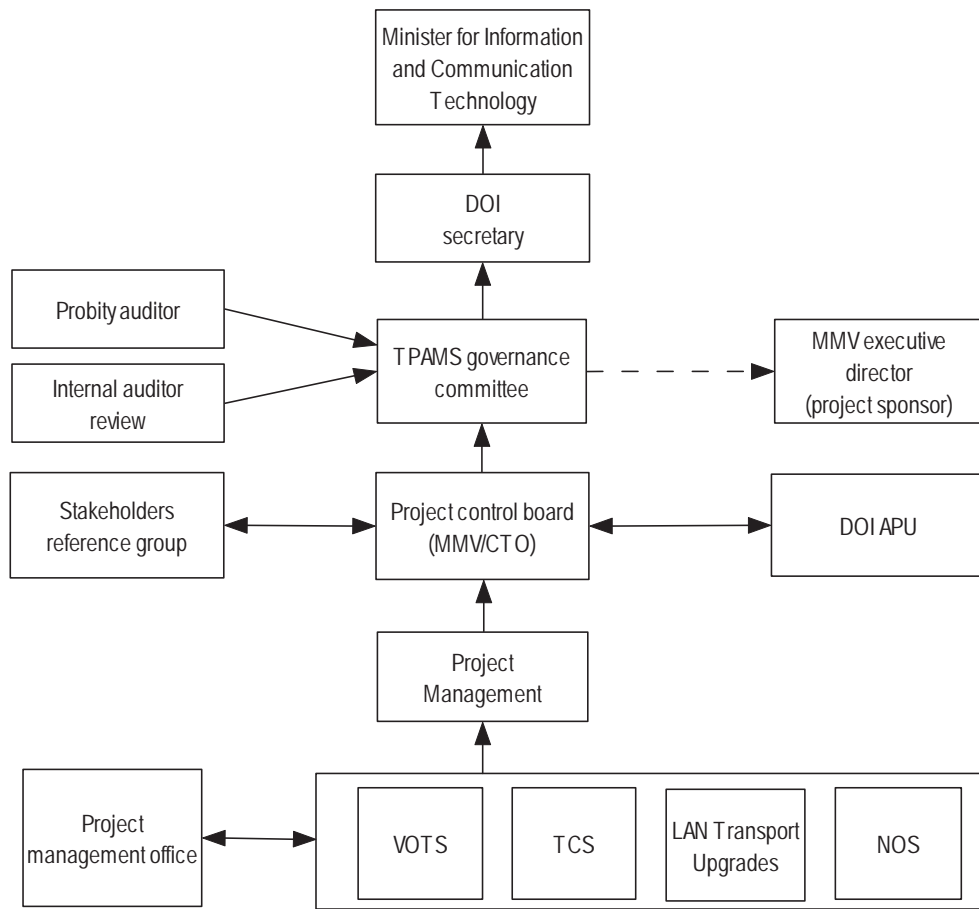
5.3 Does TPAMS have a robust governance structure?

In assessing whether TPAMS has a robust governance structure, we examined if:

- roles and responsibilities were clearly allocated
- there was regular monitoring and reporting to a project governance committee
- probity and audit arrangements were adequate
- project planning was sound.

Figure 5B shows the governance structure adopted for the management and monitoring of the whole strategy and its individual projects. The structure comprises the project control board (represented by the CTO of Multimedia Victoria), governance committee, stakeholders reference group and the reporting channels to Multimedia Victoria and the Secretary of DOI. A number of independent assurance parties (that is, internal auditors and probity auditors) have input into the governance arrangements.

FIGURE 5B: TPAMS PROGRAM GOVERNANCE & MANAGEMENT STRUCTURE



Legend:

- | | |
|--|---|
| MMV Multimedia Victoria | APU Approved Purchasing Unit |
| DOI Department of Infrastructure | VOTS Victorian Office Telephony Services |
| TCS Telecommunication Carriage Services | CTO Chief Technology Office |
| → Reporting function | - - - → Information only |

Source: Multimedia Victoria and Chief Technology Office.

The project sponsor (Multimedia Victoria), the governance committee, the project management office, and the expected users of the systems all have opportunity for input.

The governance committee¹, established in June 2003, meets regularly to assess the project management team’s risk management and project progress.

¹ The TPAMS governance committee comprises 5 members, including one DOI representative, one stakeholder representative and 3 external members with experience in government and the telecommunications industry.

The project control board (which consists of representatives from Multimedia Victoria and the CTO) makes regular and structured reports about the progress of the projects to the project sponsor and to the governance committee, using a balanced scored card² approach.

A probity auditor was employed to ensure that tender evaluation processes were fair. The projects were also subject to audit by the department's internal auditors.

The project management teams used the government's preferred *Prince2* project management methodology, and used specialist services where necessary. A comprehensive method (supported by software) of reporting and monitoring of project risks was also established.

While the established governance arrangements are quite comprehensive, we observed the following minor weaknesses that require attention:

- The Office of the Chief Information Officer (OCIO) was not involved, with the CTO, in the day-to-day management of the projects. This needs to be addressed by the OCIO accepting a more formal role in monitoring and reviewing project progress. It is acknowledged that the CTO only became responsible for the oversight of TPAMS, from a whole-of-government perspective, from October 2004.
- The project governance committee (which has responsibility for monitoring the project's progress) only monitors capital expenditure, leaving the monitoring of operating expenditure to the project sponsor, Multimedia Victoria.

Conclusion

The TPAMS governance structure is robust. There is input by a number of high-level committees, and independent assurance at various stages of projects. However, the governance structure could be improved by clarifying the monitoring role of the OCIO and by the governance committee monitoring capital and operating expenditure on each individual project.

² The balanced scorecard is a methodology where performance is judged on cost, quality and impact on service facilities, staff and to the users of the services.

Recommendations

- 1. That the TPAMS governance committee monitor whole-of-project-life costs, and capital and operating expenditure, for each of the TPAMS projects.**
- 2. That the OCIO and other central government agencies interested in whole-of-government information and communication technology (ICT) projects review and clarify their monitoring role and reporting responsibilities for large ICT projects, such as TPAMS.**

RESPONSE provided by Secretary, Department of Infrastructure

Recommendation 1 agreed. Whole-of-project-life costs should be monitored. A governance review will now be conducted as one of the next steps in a recently completed TPAMS major procurement project. The Auditor-General's recommendation will be considered as part of that review. This whole-of-project-life approach will ensure that capital expenditure is monitored during the project delivery phase. Operating expenditure continues to be managed in line with VPS budget management processes.

Recommendation 2 agreed.

RESPONSE provided by Acting Chief Information Officer, OCIO

The Office of the Chief Information Officer (OCIO) made the following recommendations to the ICT (Information and Communications Technology) Strategy Sub-Committee of the ERC (Expenditure Review Committee) of Cabinet at its meeting of 17 February 2005. These recommendations were accepted. They relate to ICT projects that receive funding from the ERC (both in past years and in future):

- that ERC ICT projects be asked to report to the OCIO with frequency determined through a risk-based assessment by the OCIO*
- that the OCIO develops a proposal, for future consideration, to create a Benefits Realisation initiative that will:*
 - develop overarching policy, guidelines and principles*
 - develop a Benefits Realisation Management methodology encompassing framework, register, implementation plan and training programs*
 - assign central responsibility for co-ordination, monitoring and reporting.*

*RESPONSE provided by Acting Chief Information Officer, OCIO
- continued*

The OCIO has defined the reporting frequency for ICT projects that received ERC funding in past years. These projects are to be asked to forward their normal reports, which are expected to cover delivery against the target schedule, progress against budget and risk management.

The OCIO plans to have a Benefits Management proposal ready for the ICT Strategy Sub-Committee by the end of July 2005.

RESPONSE provided by Secretary, Department of Premier and Cabinet

The department acknowledges your recommendation 2 that "The Office of the Chief Information Officer review and clarify their monitoring role and reporting responsibilities for large ICT Projects, such as TPAMS".

5.4 Was the contract procurement process fair and competitive, and did it follow due process?

In assessing whether the contract procurement process was fair and competitive, and whether it followed due process, we examined if it was conducted in line with Victorian government purchasing guidelines and was supported by an adequate probity audit process. The guidelines require:

- fairness and impartiality
- the use of a competitive process
- a consistent and transparent process
- confidentiality
- conflicts of interest to be identified and resolved
- compliance with legislative obligations and government policy.

We also examined how the contract processes were managed, and if contracts defined user requirements and deliverables that could be measured and monitored.

NEC Business Systems was awarded the contract to operate and update the government's CBD internal office telephone system in April 2004. Telstra and Optus were awarded contracts for the first tranche of fixed voice, data and mobile phone services in September 2004. The probity auditor assessed the 2 procurement processes as fair, and considered that the team that evaluated tenders had followed the Victorian government purchasing guidelines. DOI's internal auditor and an independent contractor also found that the processes were fair and competitive.

We also found that the Victorian Government Purchasing Board guidelines were complied with. Specifically, we found compliance with the guidelines for Victorian industry participation, advertising, submission requirements and approval by DOI's Approved Purchasing Unit. There was an adequate contract management plan, adequate resourcing, risk management policies, probity policy and audit, and transition arrangements.

We reviewed the request for tender documents and found that all specified evaluation criteria and the scope of financial information required, encouraged innovative solutions, identified the controls and ensured fairness and efficient processing, and clear instructions for delivery and lodgment.

Conclusion

The TPAMS contract procurement processes to date was fair and competitive, and due process was followed in line with Victorian government purchasing guidelines. This conclusion is supported by independent and unqualified probity audit reports.

5.5 Was TPAMS on time and within budget?

In assessing whether TPAMS was on time and within budget, we examined whether milestones were achieved and that costs were within budget.

5.5.1 Milestones

Figure 5C shows the key stages of TPAMS implementation and the originally expected timing of each stage.

FIGURE 5C: TPAMS STAGES

Stages	What the stages contain
Stage 1: Strategy and design (July 2002 - September 2003)	Development of analysis, technical and commercial requirements, a business case and draft procurement documents for implementation of a management framework.
Stage 2: Tenders and contracts (October 2003 - June 2004)	Tender evaluation and selection of suppliers to provide the designated services required by government.
Stage 3: Implementation (April 2004 - March 2005)	Delivery of initial services by successful tenderers at Melbourne's central activity district, and at metropolitan and regional sites. Services to be delivered through a competitive multi-supplier network, providing greater bandwidth at a lower per unit cost and supporting technology convergence.
Stage 4: Transition (April 2004 - June 2006)	Expansion of stage 3 services to all departments and agencies, and complete subsuming of services previously provided under the StateNet, VicOne and Telecommunications Purchasing Strategy contracts.
Stage 5: Operations and management (September 2003 - ongoing)	Implementation of new TPAMS contracts and phasing out of existing contracts.

Source: Multimedia Victoria.

At the date of our audit, Stage 1 was completed and Stage 2 was being finalised, slightly behind schedule. Stages 3, 4 and 5 have all commenced and will be ongoing until the contracts are fully implemented.

As previously mentioned, in April 2004, NEC Business Systems was awarded the Victorian office telephony services contract, to operate and update the government's CBD internal office telephone system. The phased rollout of services to departments and agencies started in August 2004. DOI expects transition to be completed by the end of April 2005.

The telecommunications carriage services tender was issued in September 2004. The first tranche of business (currently worth about \$62 million a year) was awarded to Telstra for mobile and data services, and to Optus for voice services.

The 2 tranches were expected by government to reduce departmental costs by a minimum \$73 million but, according to the TPAMS project control board, this is likely to be exceeded. Transition for tranche 1 commenced in October 2004 and is expected to be completed in April 2005 for mobile services, and October 2005 for voice and data services.

The LAN transport upgrades project was transferred to user departments. Under the strategy, \$10 million was allocated over 2 years (2003-04 and 2004-05) to departments to upgrade their local area networks.

The Network operations Support project developed an audit tool to review the accuracy and reliability of supplier billing processes. The design of this project was completed in May 2004 but was placed on-hold, pending the outcome of the tranche 2 contract award. Once tranche 2 is awarded, the project is planned to progress to implementation. This occurred in early April 2005.

Detailed transition agreements were established with the incumbent suppliers (Telstra and Optus) to ensure business continuity and ease of transition to the new services.

Each stage of TPAMS has more specific milestones, some of which were met and some of which were not. Some milestones were revised. Some milestones cross stages and projects, and this makes it difficult to determine whether specific delays will delay the final deadline. That said, we found no evidence to suggest that the 4 projects will not be fully implemented by the June 2006 deadline.

5.5.2 Budget

In July 2002, the government approved the original TPAMS budget estimate of \$55.2 million. This consisted of \$34.5 million for capital expenditure and \$20.7 million for operating expenditure.

In the TPAMS design phase, Multimedia Victoria decided that building a telecommunication network was too expensive and that services and equipment would instead be purchased by the user departments and agencies. Accordingly, the capital expenditure budget was revised in November 2003.

Figure 5D shows the TPAMS capital and operating expenditure budget, and actual expenditure at 31 March 2005 (the latest available information at the time of preparing this report).

FIGURE 5D: TPAMS CAPITAL AND OPERATING EXPENDITURE BUDGET, AND ACTUAL EXPENDITURE, TO 31 MARCH 2005

Item	Original budget July 2002 (\$m)	Revised budget November 2003 (\$m)	Actual expenditure to 31 March 2005 (a) (\$m)
Capital expenditure:			
• 2002-03	18.6	3.9	3.9
• 2003-04	15.9	20.5	10.9
• 2004-05	-	6.5	7.4
• 2005-06	-	3.6	-
Total capital expenditure	34.5	34.5	22.2
Operating expenditure	20.7	20.7	10.0
Total cost of projects	55.2	55.2	32.20

(a) The latest available figures available at the time of preparing this report were at 31 March 2005.

Source: Source: Multimedia Victoria.

As Figure 5D shows, 2003-04 expenditure was \$10.9 million (compared to the budgeted \$20.5 million). The 'underspend' includes \$4.4 million transferred to departments for their local area network upgrades in 2004-05. Capital expenditure for 2004-05 to 31 March 2005 was \$7.4 million, including the \$4.4 million transferred to other departments in 2003-04.

The TPAMS governance committee³ which has responsibility for monitoring the progress of TPAMS implementation (which we comment upon earlier in this report), only monitors capital expenditure on a total project basis and does not monitor individual project expenditure or the operating costs administered by the CTO (\$20.7 million).

³ The TPAMS governance committee comprises 5 members, including one DOI representative, one stakeholder representative and 3 external members with experience in government and the telecommunications industry.

5.5.3 Conclusion

Although there were minor delays and cost revisions, the 4 TPAMS projects are on track to meet the June 2006 deadline, and TPAMS expenditure is currently within budget.

Project cost and milestone reporting to the TPAMS governance committee needs to be improved at the individual project level and for operational expenditure.

Recommendation

- 3. That the governance committee monitors the capital and operating costs of TPAMS projects at the individual project level and for operational expenditure.**

RESPONSE provided by Secretary, Department of Infrastructure

Recommendation agreed. The department recognises the importance of the continued identification and management of emerging risks as a project moves from its procurement phase through to transition and implementation. A review of governance is being undertaken to address the on-going management of TPAMS and other whole-of-government ICT projects. The Auditor-General's recommendation will be considered as part of that review.

5.6 Were the savings and benefits expected of TPAMS realised?

In assessing whether the savings and benefits expected of TPAMS were realised, we examined if savings and benefits were clearly detailed in the business case and strategy rationale, and if they have been achieved or are indeed achievable.

In 2002, the government approved the business case for the TPAMS projects. The business case anticipated that the TPAMS projects would result in all departments (including the Office of the Chief Commissioner of Police and VicRoads) - and any other agency wanting to participate - being connected to the one telecommunications system. The business case predicted the benefits and savings would enable:

- convergence of voice and data services
- greater competition by suppliers
- greater efficiency in the use of telephony services
- the ability to handle increased volume
- cheaper call costs.

Figure 5E shows the expected benefits of the 3 service provision projects, as stated in the business cases.

FIGURE 5E: EXPECTED BENEFITS OF TPAMS PROJECTS

Victorian office telephony services project	Telecommunications carriage services project	LAN transport upgrades project
<ul style="list-style-type: none"> • \$5 million savings over 5 years • improved services and access to newer technology. 	<ul style="list-style-type: none"> • \$73 million savings over 5 years • \$40 million spent on regional infrastructure over 5 years • centralised procurement • improved service agreements. 	<ul style="list-style-type: none"> • more efficient networks • better services resulting in benefits for government and the community • connectivity between agencies, and convergence of their networks.

Source: Multimedia Victoria – TPAMS business case, 2002.

The LAN transport upgrades project already improved access to telecommunications services in regional locations and areas where telecommunication services experienced problems. For example, improvements experienced by the Department of Human Services network include:

- upgrades of facilities at major sites
- replacement of outdated technology at regional locations
- standardised local area networks at regional locations that support the data demands of the department’s main computer applications
- upgrades at 62 metropolitan and rural locations.

There was a high level of competition for both the Victorian office telephony services project and the telecommunications carriage services project tenders. TPAMS contract prices are lower than the pre-TPAMS benchmark tariffs for voice and mobile services, and VicOne tariffs for data services⁴. We expect that telecommunications costs will be lower under these projects.

At the time of our audit, it was too early to assess whether voice and data services have converged, as planned in the business case.

The project control board (which monitors and reports on the progress of TPAMS projects – refer to earlier comments on the project governance structure) told us that they expect the planned savings of \$73 million over 5 years to be exceeded. The department expects these savings to be reinvested in more bandwidth and other telecommunications services. There will not be real dollar savings, but a greatly improved service. This improved service will have an implementation cost of \$55.2 million.

⁴ The benchmark prices were identified in the Commonwealth/States Benchmarking Report, September 2004, prepared by Gibsonquai and AAS (a private sector consulting firm).

Conclusion

It is too early for us to determine if the expected benefits and cost savings from TPAMS will be achieved. However, early indications are that telecommunication prices will be lower under the new contracts, and that regional areas will have better telecommunications services.

5.7 Were the projects' risks adequately managed?

We examined if adequate processes were followed to identify key project risks and to manage these risks. Specifically, we examined measures to manage the projects' financial risks (particularly project costs and expected savings), and stakeholders' expectations of quality, timeliness and the degree to which projects would meet user requirements.

Key risks identified for TPAMS project before the tendering process were:

- departments or agencies opting out of the memoranda of understanding and the level of telecommunications carriage services for which they committed
- problems associated with phasing in the new contracts
- failure to meet the June 2006 deadline for all projects
- litigation and lobbying by unsuccessful tenderers.

As the projects progressed, the following further risks emerged:

- inadequate or unclear stakeholder communications
- that departments would not meet their contractual obligations
- contract objectives that were unclear or misinterpreted
- disputed contract deliverables or outputs
- inadequate information or data in contracts
- unclear requirements by departments
- conflicts of interests
- vague or ambiguous contracts.

We found that there were adequate governance and risk mitigation processes to ensure that all risks were monitored and adequately reviewed. Some of the early risks identified were solved by:

- suppliers agreeing to limit the government's exposure to liability
- a management process put in place to monitor non-performance
- allocating specific risks to relevant parties
- establishing a process that monitored the costs of risk management.

Conclusion

The TPAMS projects' risk management and monitoring mechanisms are robust. However, as programs move into later stages, risks will change. We expect 2 risks to increase and they will need to be adequately managed, namely the department and agency take-up of telecommunication services and the ability of the CTO to manage a variety of suppliers of telecommunications services.

Recommendation

- 4. That the CTO ensures it is able to identify and manage emerging risks as TPAMS projects move into later stages.**

*RESPONSE provided by Secretary, Department of Infrastructure
Recommendation agreed.*



6. Management of Overseas Projects Corporation of Victoria Ltd's major assets sale



6.1 Audit conclusions

The Overseas Projects Corporation of Victoria Ltd has experienced considerable financial difficulty over recent years. Advice from its board that it was not a core government business, contributed to the government's decision in October 2003 to sell the company.

The objective of the sale was to achieve the best possible return, while at the same time fulfilling a number of other aims, including to achieve a speedy sale, maintain high standards of probity, minimise continuing risks to the state and ensure the ongoing operation of the company's business.

In June 2004, the company concluded an asset sale agreement with a private party, for \$1.4 million¹. This agreement sold the company's interest in most of its ongoing major projects and partnering arrangements, and its trading name. It also transferred almost all of the company's permanent employees to the buyer. The buyer also agreed to manage, on the company's behalf, those projects retained by the company on a fee-for-service basis.

Our audit examined the adequacy of the sale process, the outcomes achieved, and the arrangements established for the eventual wind-up of the company and the management of any residual issues.

To achieve a satisfactory sale outcome, it was important for the sale to be completed expeditiously given the nature of the company's business, and the importance of ensuring that the skills and experience of its employees were retained during this period. It was equally important that due process, including a high standard of equity, transparency and probity, was maintained throughout. This report concludes that while the sale was conducted expeditiously, under difficult circumstances, some procedural matters were deficient.

While acknowledging that there were several strengths in the process adopted for the sale (including comprehensive sale documentation and the engagement of a probity adviser), and that the sale process was made more difficult by the company's considerable financial difficulties, there are lessons to be learned for future asset sales, including:

- key sale documents (such as those that seek expressions of interest or proposals) should be formally approved prior to their issue to the market

¹ Net of employee entitlements, valued by the company at \$170 000.

- probity plans issued to bidders should be followed, particularly in respect of the role of probity advisers and the contract negotiation processes
- the conclusions and recommendations of the bidder selection committee should be formally documented and signed-off by its members
- where the nature of a sale changes during the sale process (for example from a sale of a company to a sale of the company's assets), at least all short-listed bidders should be given the same opportunity to submit proposals
- committees established to oversee the conduct and management of the sale of an entity should take a leadership role, not become an integral part of the conduct of the sale and should be independent of the entity's board or management, therefore ensuring the government's ownership interests are protected
- advisers to a sale process, which have an affiliation or interest which might create a possible perception of a conflict of interest, should not participate in the process
- the successful bidder should not be allowed to take over the entity (or the purchased assets) before the sale agreement had been finalised.

The cash proceeds of the sale, which were received by the company and totalled \$1.4 million, fell below the company's revised valuation of the projects sold (\$1.5 million) and the original estimated proceeds for the sale of the company as a whole (\$2.5 million). Further, the state continues to bear risks arising from the unsold projects of the company. Nevertheless, based on the 2 offers received, the state achieved the highest available cash return on the sale.

The state has contributed some \$9.9 million as capital to the company since its inception in 1985. In addition, in June 2004, the state provided a grant of \$400 000 to the company to meet some of its debts. In return, the company has contributed dividends totalling some \$800 000 to the state since 1992. However, at 30 June 2004 (after taking into account the proceeds from the sale), the company's net assets amounted to \$1.3 million, with a further \$317 000 estimated as being needed to complete its wind-up. Clearly, the majority of the state's investment in the company has been lost. We acknowledge that the operations of the company have contributed to the generation of economic benefits for Victoria.

The wind-up of the company's affairs was incomplete at the time of preparing this report and an up-to-date plan (and budget) needs to be prepared and approved for this purpose.

6.2 Background

The Overseas Projects Corporation of Victoria Ltd was established in 1985 as a state-owned company. Its mission was to export Victorian public and private sector skills (such as project management skills), technologies and equipment to external markets. Most of its work has focused on projects conducted in developing countries.

In recent years, the company has experienced considerable financial difficulties. These have required the government to provide additional capital injections and other financial support to the company to ensure that it remained solvent. Our previous reports to parliament have commented in detail on these financial difficulties, and the reasons why².

In light of advice from the company's board and senior management that the company was not a core government business, the government approved a proposal to sell the company in October 2003. During February 2004, with the government's support, the sales strategy changed to a sale of the company's assets and other business interests (rather than a sale of the company as an entity). This decision was taken based on advice that a sale of the company was highly improbable and that the most feasible, and best, option for the state was an asset sale.

The sale process concluded with the finalisation, in June 2004, of an agreement to sell the majority of company assets to a preferred bidder, a professional services consulting firm. The sale agreement specified the assets to be sold, including the net assets of 22 major projects (including intellectual property rights and novation of relevant project contracts), some plant and equipment, the company's trading name and the lease of the company's premises. The agreement also provided for almost all of the company's remaining permanent employees to be transferred to the buyer.

In addition, the buyer agreed to manage, on the company's behalf on a fee-for-service basis, the projects retained by the company (26 projects, most of which were physically complete).

Proceeds from the sale totalled \$1.4 million and were received by the company in June 2004 (\$1.2 million) and August 2004 (\$200 000).

² Victorian Auditor-General's Office, 2004, *Report on Public Sector Agencies, Results of special reviews and financial statement audits for agencies with 2003 balance dates other than 30 June*, Victorian Government Printer, Melbourne, May 2004. Victorian Auditor-General's Office, 2004, *Auditor-General's Report, Results of 30 June 2004 financial statement and other audits*, Victorian Government Printer, Melbourne, December 2004.

While it had been proposed that the company would be wound-up voluntarily and a liquidator be appointed at a shareholder meeting during September 2004, finalisation of a number of matters delayed the appointment of a liquidator until February 2005. At the date of preparing this report, the wind-up of the company's affairs was incomplete.

6.3 Purpose of audit

This audit examined the sale to assess whether:

- appropriate processes were followed in the sale process
- a reasonable sale outcome was achieved for the state, and what has been the level of financial support provided by the state
- appropriate arrangements were established or planned to manage the eventual wind-up of the company and any related residual issues.

6.4 Were appropriate processes followed for the sale?

6.4.1 Were sale arrangements adequate?

In assessing the adequacy of the arrangements adopted for the sale, we examined if:

- the decision to sell the company (or its assets) was supported by a clear and valid rationale, and was approved by the responsible minister
- a steering committee with appropriate representation from relevant central government agencies (the Department of Industry, Innovation and Regional Development, and the Department of Treasury and Finance) oversaw the sale
- there was adequate communication to all relevant stakeholders (including the company's existing clients), to ensure that the sale outcome was maximised
- the responsible minister approved the sale agreement.

The Minister for State and Regional Development and (on the minister's recommendation) the government approved a proposal to sell the company in October 2003. Those approvals were given in light of the company's poor performance in recent years. They were based on the advice of the company's board and senior management that the company was not a core government business, and that selling it would enable it to raise the capital needed to compete at a global level.

The sale objective (as set out in the expression of interest document) was to maximise the net return to the state, consistent with:

- ensuring a high standard of equity, transparency and probity in the sale process
- minimising the potential impact on the state of the company's business risks after the sale
- a relatively speedy and efficient sale process
- ensuring that the successor business will be established in such a way as to provide a sound basis for:
 - the ongoing sustainability of its operations
 - the satisfactory completion of existing projects and the further development of the company's client relationships
 - the continued contribution to the export of Victorian-based professional and government advisory services
 - equitable treatment for the company's staff and the ability to provide for ongoing career development.

A working group was established in December 2003 to oversee (and undertake a key role in) the sale process. Membership of the working group comprised the company's chairman (who chaired the group), the acting managing director, and a senior manager from each of the Department of Innovation, Industry and Regional Development and the Department of Treasury and Finance³. A number of consultants also provided expert advice to the working group. The company's board was made responsible for managing the sale process. These arrangements had the support of the Department of Innovation, Industry and Regional Development and the Department of Treasury and Finance.

The working group undertook the evaluation of expressions of interest and proposals, and members informally reported the group's progress and findings to the respective stakeholder agencies.

Although there was no evidence of a conflict of interest, given that the company's board (and particularly its chairman and acting managing director) played a key role in the sale process (which sought to divest the company's entire business and assets), there was a risk of a conflict of interest situation or perception arising. This was because the board was required, as part of the sales process, to consider proposals from existing business partners and competitors.

³ Late in the sale process, the Department of Treasury and Finance senior manager retired from the department and was not replaced on the working group.

These arrangements are also not consistent with good practice and guidance issued by the Department of Treasury and Finance, which aims to eliminate the occurrence of possible or actual conflict of interest situations. The Department of Treasury and Finance guidelines on *Procedural Integrity and Process Auditing in Privatisations and Contracting Out* (issued in 1997) state that representatives of an entity to be sold should not be on the selection committee for the sale, for reasons of potential or perceived conflicts of interest.

Separate guidance issued by the Department of Treasury and Finance on *Best Practice Advice - Probity*, further states that conflict of interest situations arise where a participant in (or adviser to) a project team has an affiliation or interest which might be seen to prejudice his or her impartiality. The guidance recognises that conflicts of interest can occur and, provided they are identified early and dealt with effectively, do not necessarily suggest or indicate any wrongdoing.

At several key points in the sale process, the Secretary to the Department of Innovation, Industry and Regional Development and the Minister for State and Regional Development were briefed by their departmental representative on the working group, and/or the board on the progress of the sale.

While the proposed high level plan prepared for the sale did not specifically include a communication strategy, key stakeholders (including clients, business partners and employees) were kept informed about the sale's progress.

In May 2004, a special meeting of the board was convened with shareholders (representing the minister on behalf of the state) to approve the sale agreements, subject to any subsequent amendments agreed by the company. The acting managing director subsequently signed the sale agreements in early June 2004 on behalf of the company. The board and the minister were later advised that the sale agreement documents had been executed.

Conclusions

The decision to sell the company was based on a clear and valid rationale, and adequately communicated to relevant stakeholders.

The company did not represent a major undertaking of the state and, therefore, its sale did not require as extensive a governance regime as would be expected for a major asset sale. On balance, an adequate governance structure was initially created whereby a working group, including senior departmental representatives, was established to oversee the company's management of the sale process.

However, by undertaking the assessment of expressions of interest and proposals, the working group (which included members of the company's board), became an integral part of the sale process rather than oversighting the company's management of the sale process. This exposed the group to a potential conflict of interest risk. This situation should not have occurred, and the 2 portfolio departments should have played a greater leadership role to protect the government's ownership interest in the company.

The lesson for future similar sales is that committees established to oversee the conduct and management of a sale of an entity should take a leadership role, not become involved in the conduct (that is, become an integral part) of the sale, and should be independent of the entity's board or management.

The sale agreements were appropriately approved.

RESPONSE provided by the Secretary, Department of Innovation, Industry and Regional Development

The Department believes a reasonable outcome was reached due to sound governance practices for the duration of the sale and adequate direction throughout the sale process. The Board's involvement in the sale directly contributed to the objectives of a smooth transition, retaining as many employees as possible and retaining a presence in Victoria.

RESPONSE provided by the Chairman, Overseas Projects Corporation of Victoria Ltd

The Board disagrees about the lesson for future similar sales about whether a Board should be involved in the sale. It depends on the objectives of the sale and whether any member of the Board has an ongoing interest in the entity beyond the sale. In this circumstance, involvement of the Board contributed to the objectives of a smooth transition, retaining as many employees as possible and retaining a presence in Victoria.

6.4.2 Were probity arrangements adequate?

In assessing whether high standards of probity were maintained during the expression of interest, proposal clarification, contract negotiation and other sale process phases, we examined if:

- the sale plan (and/or business case) clearly set out the sale strategy, provided for a consistent and transparent process, and was prepared and approved before the request for expressions of interest was released
- expression of interest and request for proposals documentation was consistent with the sale plan, sufficiently comprehensive (including for example, conditions of sale, evaluation criteria and contract requirements) and was properly approved before being issued
- evaluation committee members had adequate skills, no conflict of interest, reviewed bids solely against the stated evaluation criteria and were supported by expert advice as required
- the evaluation process was timely (in line with the sale plan), appropriate and fair
- the evaluation committee's reports clearly set out a valid rationale for the acceptance or rejection of bids, consistent with achieving the best sale outcome taking account of any risk or cost transfers to the state.

In order to minimise any possible adverse impact on operations and subsequent loss of value, the company's board supported a streamlined sale process. Given that the sale objectives included ensuring high standards of equity, transparency and probity, the board was required to maximise the outcome of the sale for the state (and for the company's employees) while also ensuring that the public interest was protected by adopting due process at all stages of the sale.

A proposed high level plan for the sale was prepared during November 2003 which set out the sale process, governance arrangements, timetable, evaluation criteria, a broad estimate of the cost of the sale and the proposed content of the request for expressions of interest document. This plan was provided to the company's board, the Department of Innovation, Industry and Regional Development and the Department of Treasury and Finance. However, we found no evidence that the sale working group (or the company's board) had formally approved the proposed plan. The company's board did however agree to an indicative timetable for the sale process, the formation of the sale working group, appointment of consultants and the advertisement to seek expressions of interest.

A probity plan was also prepared. The plan set out the major phases of the sale process, potential probity issues and key probity steps and sign-offs. Details of the probity plan were included in the request for proposal document. This committed the company to the plan, although we found no evidence once again that the sale working group (or the company's board) had formally approved the plan. Similarly, we found no evidence that either body had formally approved the expressions of interest document or request for proposals document. However, both these latter documents were issued under the cover of a letter signed by the company's chairman, and were comprehensive and consistent with the sale plan.

We observed several other weaknesses in the sale process, including:

- Reports detailing the probity advisor's conclusions on the sale process, a requirement of the probity plan, were not prepared.
- The evaluation panel (comprising the sale working group, less the company's chairman) did not prepare and sign reports on the results of their evaluation of the expressions of interest and proposals, and other key decisions. The company's acting managing director (also a working group member) did, however, brief the company's board on the working group's activities, findings and recommendations, as part of his regular monthly report to the board.
- The sale working group's key adviser (a consultant) had a potential conflict of interest during the sale process, related to the successful bidder. Prior to seeking proposals from short-listed respondents, the advisor was working closely with the successful bidder on another project for a third party. There was no evidence that either the working group or the company's board formally considered this potential conflict of interest. We were, however, advised that this matter was considered by the working group, which concluded that there was no potential or actual conflict of interest. The advisor, who had participated in the evaluation of expressions of interest, continued to advise the evaluation panel at the request for proposals phase.

- All short listed respondents to the expression of interest process were not given the opportunity to submit purchase bids. The company's board, at its meeting of 28 January 2004, was advised that 8 respondents met all of the requirements of the expressions of interest and accepted a recommended short list of 4 respondents (the remaining 4 respondents were to be held in reserve). The Secretary of the Department of Innovation, Industry and Regional Development endorsed the board's decision to short list 4 respondents on 2 February 2004.

The board, at its meeting of 24 February 2004, endorsed a recommendation to change the nature of the sale from a sale of the company to a sale of the company's assets. The board at its meeting of 2 March 2004 was advised that further meetings had been held with the 4 selected short-listed respondents and that one of the short listed respondents, together with the reserve respondents, would be advised they were unsuccessful. This decision was taken in order to advance the sale in line with the company's timetable and was despite all 4 respondents having indicated their willingness to submit proposals to buy the company. The Secretary of the Department of Innovation, Industry and Regional Development was advised on 3 March 2004 that the company's board had endorsed a recommendation to proceed with the 3 short listed respondents.

Consequently, only 3 short-listed bidders (from around 20 entities that had lodged expressions of interest in buying the company) were given the opportunity to prepare proposals when the nature of the sale changed, from a sale of the company to a sale of the company's assets. This is contrary to good practice and Department of Treasury and Finance probity guidelines which provide that at least all short-listed entities should be given the opportunity to submit proposals if the nature of the sale changes. This ensures that at least all the short-listed entities have the same opportunities and information. It also provides greater assurance to the state that the best possible sale outcome will be achieved⁴.

- While the probity plan required 3 members of the working group to conduct final negotiations in the presence of the probity adviser, this did not occur as one member of the group solely negotiated the sale agreement (and progressively advised members of the company's board and/or the working group on the status of the negotiations).

⁴ While proposals were sought from 3 short-listed parties, in fact only 2 were ultimately received for the purchase of the company's assets.

After the decision about the preferred bidder was taken at the end of April 2004, the company allowed the bidder to take control of the purchased projects, employ the company's staff and commence management of the company's other projects approximately one month before the sale agreement had been finalised (although a letter of intent had been signed by the parties). Negotiations about the terms and conditions of the sale (including the assets to be sold) continued to take place after the purchaser had assumed control of the company's business. This was contrary to probity advice received by the sale working group, and would undoubtedly have had the potential to weaken the negotiating position of the state.

We were advised that the company permitted the above in order to enable an orderly transition of staff and projects; to provide continuity for the company's clients; to maximise employment prospects for its employees and to minimise further loss of the company's staff.

After the letter of intent was signed on 3 May 2004:

- 2 additional projects were purchased and one project was dropped from the list of projects to be purchased (changing the purchase price)
- the state was obliged to maintain the solvency of the company until 30 June 2005
- a further agreement was executed for the management of the company's remaining projects.

Although the original timetable for the sale was to execute the sale agreement in mid-March 2004, this did not occur until early June 2004. This was largely due to the changed nature of the sale, from a share sale to an asset sale, and the challenge of seeking to sell a company in considerable financial difficulty.

Conclusion

The objective of the sale process was to achieve the best possible return, while at the same time fulfilling a number of other aims, including to achieve a speedy sale, maintain high standards of probity, minimise continuing risks to the state and ensure the ongoing operation of the company's business.

To achieve a satisfactory sale outcome, it was important for the sale to be completed expeditiously given the nature of the company's business and the importance of ensuring that the skills and experience of its employees were retained during this period. It was equally important that due process, including a high standard of equity, transparency and probity, was maintained throughout. In our opinion, while the sale was conducted expeditiously under difficult circumstances, some procedural matters were deficient.

While acknowledging that the sale process was made more difficult by the company's considerable financial difficulties, and that there were also several strengths in the process adopted (including comprehensive sale documentation and the engagement of a probity adviser), there are lessons to be learned for future asset sales, including:

- key sale documents (such as those that seek expressions of interest proposals) should be formally approved prior to their issue to the market
- probity plans issued to bidders should be followed, particularly in respect of the role of probity advisers and the contract negotiation processes
- the conclusions and recommendations of the bidder selection committee should be formally documented and signed-off by its members
- advisers to a sale which have an affiliation or interest which might create a perception of a possible conflict of interest should not participate in the sale process
- where the nature of a sale changes during the sale process (for example, from a sale of a company to a sale of the company's assets), at least all short-listed bidders should be given the opportunity to prepare proposals
- the successful bidder should not be allowed to take over the entity (or the purchased assets) before the sale agreement is finalised.

RESPONSE provided by the Secretary, Department of Innovation, Industry and Regional Development

The report misinterprets the short-listing process. Of around 20 entities that lodged expressions of interest in buying the company, 4 were identified as fully satisfying the EOI requirements. After deliberation, a shortlist of 3 was agreed and all 3 were given the opportunity to prepare proposals.

The Board decided on 2 March, 2004 that there were 3 short-listed bidders. All respondents to the Expression of Interest that were not short listed to progress to the Request for Tender stage were informed in writing.

RESPONSE provided by the Chairman, Overseas Projects Corporation of Victoria Ltd

The draft report misinterprets the short-listing process. Of around 20 entities that lodged expressions of interest in buying the company, 4 were identified as the group the shortlist would be chosen from. After deliberation, a shortlist of 3 was agreed and all 3 were given the opportunity to prepare proposals.

The Board decided on 2 March 2004 that there were 3 short-listed bidders. All respondents to the Expression of Interest that were not short listed to progress to the Request for Tender stage were informed in writing.

The Board agree with the conclusions about future sales. However, the Board do not accept the implication that such things did not occur with the sale of the OPCV. For example, key sale documents such as the EOI proposal were approved before issue to the market. Also, all short-listed bidders were given the same opportunity to prepare proposals.

In relation to the conclusion as to whether the successful bidder ought to take over the entity after a letter of intent is signed but before the sale agreement is signed, the Board believe that it depends on the circumstances. The Board concluded that allowing the purchaser to take over the entity would maximise the likelihood of sale and maximise the ongoing employment of employees and the novation of all contracts by the clients (all key objectives of sale).

6.5 Were the sale outcomes reasonable?

In assessing the reasonableness of the sale outcomes, we examined if:

- the sale proceeds, together with any risks or costs assumed by the state, compared favourably with other offers received and the value of the assets sold
- the state eliminated or minimised any financial or other risks relating to the assets sold or the ongoing operations of the company
- the cost of conducting the sale was within budget and properly recorded.

Based on the 2 offers received from bidders, while confronted with conditional bids containing some uncertainties and differing risks profiles, the state achieved the highest available upfront cash proceeds.

A review of the company's accounting estimates (by its accounting advisers) during the sale period led the company to write-down its valuation of the sold projects by \$1.4 million, to \$1.5 million at 30 June 2004. This compares with the total cash sale proceeds of \$1.4 million.

The cash sale proceeds were below the estimate of \$2.5 million originally provided to the minister during October 2003, based on a sale of the company as a whole (as opposed to an asset sale).

An objective of the sale was to minimise the potential impact on the state of the company's business risks after the sale. The following risks were to be borne by the state under the sale agreements:

- The company has indemnified the purchaser against any loss or claim in relation to every debt or liability of the company's business incurred before 1 May 2004, except if incurred by the purchaser. This indemnity includes any liabilities in respect of the major projects sold.
- The state must maintain the solvency of the company until 30 June 2005; more than 12 months after the assets were sold.
- The company continues to be responsible for the projects it was unable to sell (26 projects, most of which are now physically complete).

During February 2005, the buyer entered into a deed of release with the company, whereby the company was discharged from responsibility for any loss or claim connected with the major projects sold for the period prior to 1 May 2004, except for any liability arising from claims made by contractors, employees and government agencies. This deed of release became operative upon payment of \$75 000 by the company to the buyer.

In December 2003, the sale was budgeted to cost \$310 000. In January 2004, this was revised to \$390 000. This budget was to cover the cost of consultants to provide legal, accounting, due diligence, probity and sale coordination services, and some printing costs. A total of \$453 000 was actually spent on consultants and other sale costs. The increase in costs was mainly due to significantly higher legal and probity advice costs, and some increases in accounting advice costs. The extended sale period and the change in the nature of the sale also contributed to these additional costs.

Conclusion

While retaining some risk, the company sold its interest in most of its major ongoing projects and partnering arrangements, and achieved the highest upfront cash proceeds based on the 2 proposals received.

However, as not all short-listed bidders were invited to prepare proposals on the basis of a sale of the company's assets, we are unable to conclude on whether or not the outcomes of the sale for the state were maximised.

RESPONSE provided by the Secretary, Department of Innovation, Industry and Regional Development

The Department notes with satisfaction the conclusion that the sale outcomes were reasonable. Great effort was taken throughout the sale to ensure a fair and equitable process and to ensure that all short listed bidders were given the same opportunity to prepare proposals.

RESPONSE provided by the Chairman, Overseas Projects Corporation of Victoria Ltd

Agree with the first paragraph of audit's conclusion.

The Board do not accept the second paragraph as in fact, all 3 short listed bidders were given the same opportunity to prepare proposals.

6.6 What has been the level of financial support provided by the government to the company?

We examined the total level of financial support provided by the government to the company since its establishment, and any associated undertakings made, and risks and costs assumed, by the state as part of the sale process. We verified that this level of financial support had been reported to, and approved by, the responsible minister.

At 30 June 2004, the company had about \$1.3 million in net assets (refer Figure 6A)⁵. This was despite:

- the state having provided the company with total capital contributions of \$9.9 million up to 30 June 2004, including \$4.4 million provided in June 2004
- the state providing a grant of \$400 000 during June 2004 to meet some debts of the company
- the proceeds from the sale of the major projects already being taken into account in calculating the company's June 2004 net asset position.

⁵ Refer to commentary on the company's financial difficulties, included in Victorian Auditor-General's Office, 2004, *Report on Public Sector Agencies, Results of special reviews and financial statement audits for agencies with 2003 balance dates other than 30 June*, Government Printer, Melbourne, May 2004, and Victorian Auditor-General's Office, 2004, *Auditor General's Report, Results of 30 June 2004 financial statement and other audits*, Government Printer, Melbourne, December 2004.

FIGURE 6A: FINANCIAL POSITION OF THE OVERSEAS PROJECTS CORPORATION OF VICTORIA LTD (\$'000)

	30 June 2004	30 June 2003
Contributed capital	9 886.1	5 500.0
Accumulated deficit	(8 640.8)	(942.8)
Net assets	1 245.3	4 557.2
Operating deficit	(7 698.0)	(3 488.6)

Source: The company's annual financial report.

One of the sale objectives was to minimise the potential impact on the state of the company's business risks after the sale. As noted earlier in this report, under the sale arrangement the state continues to bear certain risks arising from the unsold projects of the company.

At a number of key points in the sale process, the Secretary to the Department of Innovation, Industry and Regional Development and the Minister for State and Regional Development were briefed on the financial position of the company and the progress of the sale, including the board's request for an indemnity. Further, a special meeting of the board was convened with the shareholders (representing the minister on behalf of the state) in May 2004, which approved the sale agreements, subject to any subsequent amendments agreed by the company. The minister was subsequently advised that the sale agreements had been formally executed.

The Treasurer issued an indemnity for the company's board and officers in respect of the sale. The Secretary to the Department of Innovation, Industry and Regional Development issued a letter to the purchaser, which undertook to maintain the solvency of the company until 30 June 2005.

Conclusion

The state has contributed some \$9.9 million as capital to the company since its inception in 1985. In addition, in June 2004, the state provided a grant of \$400 000 to the company to meet some of its debts. In return, the company has contributed dividends totalling some \$800 000 to the state since 1992. However, at 30 June 2004, the company's net assets amounted to \$1.3 million (after taking into account the proceeds from the sale), with a further \$317 000 estimated as being needed to complete its wind up. Clearly the majority of the state's investment in the company has been lost. We acknowledge that the operations of the company have contributed to the generation of economic benefits for Victoria.

RESPONSE provided by the Secretary, Department of Innovation, Industry and Regional Development

The department notes with satisfaction the general conclusion.

6.7 Are residual issues being effectively managed?

In assessing whether the residual matters for the company are being adequately managed, we examined if:

- a plan had been prepared to manage the key residual issues
- wind-up processes were in place and activity taking place in line with the approved timetable
- the responsible minister had approved processes to wind-up or dissolve the company.

In June 2004, the company's chairman and acting managing director discussed their plan to wind-up the company with the Minister for State and Regional Development. That plan provided for the:

- payout of the 2 remaining permanent staff of the company in June 2004 - took place in that month
- settlement of all claims and debts of the company by mid-July 2004, including closing international bank accounts - incomplete at the time of preparing this report
- transfer of residual matters to the Department of Industry, Innovation and Regional Development by the end of July 2004 - had not occurred at the time of preparing this report (the acting managing director and chief financial officer continue to manage the company's residual issues)
- finalisation of the company's 2003-04 financial statements by the beginning of August 2004 - occurred in mid-September 2004
- finalisation of the remaining company projects by November 2004, including related legal disputes - incomplete at the time of preparing this report.

The original estimate of the cost of winding-up the company (including resolution of the remaining projects) was \$427 000. This included a contingency allowance of \$127 200 as some project related costs were very difficult to quantify at that time.

It had been proposed that the company would be wound-up voluntarily and a liquidator appointed at a shareholder meeting in September 2004. However, that meeting was adjourned before those motions were put, to allow time for the resolution of certain matters related to the appointment of a liquidator and the company's asset sale. The liquidator was ultimately appointed during February 2005.

At the time of preparing this report, 3 board members continued to hold office. In addition, the acting chief financial officer continued to assist in the wind-up of the company's affairs.

A status report on the winding-up of the company's affairs, including a current estimate of net costs totalling \$317 000, was presented to the Minister for State and Regional Development during March 2005.

Conclusion

A number of matters remain to be concluded before the company can be wound-up. These have taken longer to resolve than originally estimated.

Recommendation

- 1. That the board of the Overseas Projects Corporation of Victoria Ltd, together with the liquidator and the Department of Industry, Innovation and Regional Development, prepare a revised plan for winding-up the company's affairs for the approval of the Minister for State and Regional Development.**

RESPONSE provided by the Secretary, Department of Innovation, Industry and Regional Development

The Department accepts the conclusion and recommendation to work with the Board and the liquidator in the preparation of a revised wind-up plan.

RESPONSE provided by the Chairman, Overseas Projects Corporation of Victoria Ltd

The Board accept the conclusion and recommendation, and a revised plan for winding up the company's affairs was submitted to the minister on 21 March 2005.



7. Implementation of the Government Infrastructure Management System project



7.1 Audit conclusion

The Government Infrastructure Management System (GIMS) project has provided participating agencies in the Justice portfolio with software to help them better manage their non-current physical assets (such as land, buildings, plant and equipment).

The Department of Justice (DoJ) planned to fully implement the software by January 2003 across a number of its business groups (Corrections Victoria; Courts and Tribunals; and the Victoria State and Emergency Services) and portfolio agencies (Victoria Police and the Country Fire Authority). At the time of this audit (February 2005), the software was not fully implemented within the DoJ business groups.

Our review of the project's management found that better project governance and coordination would have reduced some of the delays encountered. Specifically, we found that:

- key project documentation was not formally approved
- more senior departmental representation was needed on the project steering committee
- risk management practices were not adequate
- there was no independent quality assurance throughout the project.

One of the aims of the GIMS project was to enable cross-agency comparisons, monitoring and benchmarking of asset management performance. This aim has not been achieved by participating agencies, as not all are recording all common assets (such as plant, equipment and buildings). Unless there is greater standardisation of approaches and asset types recorded, this aim (and one of the stated benefits of the project software) will be difficult to achieve.

With the GIMS software now being considered for use by other public sector agencies, it is important that a full post-implementation review of the Justice portfolio GIMS project be conducted. This will ensure that public sector agencies benefit from the lessons learned by Justice portfolio participating agencies.

RESPONSE provided by Secretary, Department of Justice

The Department of Justice welcomes the Auditor-General's review, and accepts all the recommendations of the report in relation to the Government Infrastructure Management System (GIMS) project. They will assist us in further improving the planning and management of our major projects which is one of our corporate strategic priorities for 2005.

The department acknowledges that prior to 2004 there were gaps in the GIMS project management and governance arrangements. The department has addressed these issues by appointing a new project manager and reviewing the governance arrangements against the ITIL (Information Technology Infrastructure Library) set of best practice standards for IT service management. Consequently, we have developed more detailed project, resource and communications plans, and adopted more regular reporting on project status, scope, budget, risks, and risk mitigation strategies.

The department will also address the remaining issues identified in the audit report, including conducting an overall project implementation review within 6 months of the GIMS implementation in the department, scheduled for July 2005.

It is important to note that the department's usual practice is to formally endorse and monitor project plans and budgets for IT projects. Depending on the project size and complexity, this is done by the Justice Executive, the Knowledge Management Committee, or a Project Steering Committee. As part of the progressive roll-out of the PRINCE 2 project development methodology in the department, provision is made for the inclusion of the quality assurance function for projects.

The Department of Justice pioneered the development and implementation of GIMS for the benefit of the whole of Victorian public sector. Some of the difficulties encountered were due to the groundbreaking and complex nature of the project. The department's experiences as the pilot site will be captured and made available to assist other government departments and agencies should they take up the system.

A recent evaluation by the Office of the Chief Information Officer confirmed the GIMS's applicability across the Victorian public sector. The department is currently assisting in the establishment of an Open Standing Offer Agreement, which will enable other government departments and agencies to take up the system if they so wish.

7.2 Background

The state owns or leases a large number of physical assets (such as land, buildings, plant and equipment), which are used to provide services to the public.

In 1998, a DoJ review of the Justice portfolio's asset management practices found major deficiencies in how information about physical assets was collected, recorded and reported. It found the mix of financial management systems, databases and paper records to be inadequate.

In March 2000, DoJ proposed to the government that an infrastructure management system be established for Justice portfolio agencies. However, the government considered that such a system should operate across the whole public sector. Consequently, in June 2000, the Treasurer approved funding for the GIMS Project.

The project aimed to improve asset management policies and procedures and to provide public sector agencies with computer software to:

- generate better reports about all aspects of asset management
- enable comparisons across agencies of the total investment in assets, operating costs and asset uses
- provide information about short and long-term asset needs
- provide information about the short and long-term budget consequences of different ways of acquiring, disposing of and maintaining assets
- monitor and benchmark the performance of agencies in managing their assets.

As DoJ had initiated the project, the Justice portfolio was chosen as the pilot site. The participating agencies were:

- Victoria Police
- Country Fire Authority (CFA)
- DoJ (including Corrections Victoria; Courts and tribunals; and Victoria State and Emergency Services [VicSES])

Following the completion of a tender process in 2001, a contract was awarded to a private sector contractor in March 2002 to provide and configure for use by the participating agencies 3 software products, focusing on:

- asset and project management - to support the management of asset acquisitions and disposals, maintenance scheduling, and capital construction projects
- tenancy lease management - to support property management

- system interface - to link the above software products to each other and to other software as required.

DoJ intended for the GIMS software to be in use by all participating agencies by 21 January 2003, and for it to be in use by Victoria Police by November 2002.

Our audit examined whether the GIMS project was adequately defined, implemented and managed¹.

7.3 Was the project adequately defined?

In assessing whether the GIMS project was adequately defined, we examined if:

- the project scope and implementation methodology were well-defined
- the implementation methodology included the allocation of staff responsibilities, a breakdown of tasks, timeframes, budgets, milestones and approval processes
- project governance arrangements were adequate
- adequate project plans were developed.

Following the review in 1998 of DoJ asset management practices, a detailed business case was prepared for the development of common practices - and the implementation of software to support these practices. A steering committee consisting of representatives from across the Justice portfolio oversaw this process.

The tender process was conducted between September 2000 and October 2001. After the contract was awarded, the contractor (under the direction of DoJ) developed a project charter and implementation plan. These documents defined the project scope and included the project management methodology. They allocated responsibilities and tasks and identified milestones, and approvals required. However, the charter and plan were not formally approved by the steering committee.

A detailed budget, covering all aspects of the project, was not prepared at the start of the project.

¹ In September 2003, following a tender process, DoJ awarded a further contract to the GIMS contractor for the provision of an additional software module relating to contract management. This constituted a separate project (albeit, within the GIMS project) and was therefore not examined as part of this audit.

In May 2002, DoJ established a new project steering committee comprising 10 representatives of the participating agencies/business groups. In September 2002, this committee was reconstituted as the Project Executive Steering Committee, and comprised the project sponsor as Chair (a Director within DoJ), the Victoria Police Implementation Coordinator and the CFA Project Director.

The committee did not have the authority to allocate resources from the participating agencies and business groups. On several occasions, necessary resources were not forthcoming, in a timely manner, to implement the project.

In 2002, DoJ engaged consultants to review the project documentation. Their report recommended that DoJ's Deputy Secretary Corporate Services, and like people from other participating agencies, be appointed to the committee. They also recommended that DoJ ensure that the project was adequately resourced with the necessary staff.

DoJ originally intended to manage project implementation centrally. However, due to delays in progressing the project, Victoria Police and CFA managed their implementation separately, and each developed separate project plans that were coordinated centrally.

At several stages during the project, milestones were not achieved for individual participating agencies within the specified timelines. In some cases, timely action was not taken to set new timelines.

Conclusion

DoJ did not formally endorse the contractor's charter and plan or develop an initial budget covering all aspects of the project. These were major shortcomings in the process.

Governance of the project, and coordination of participating agencies, would have been improved by the participation of a more senior departmental representative on the steering committee.

Recommendations

- 1. That DoJ, in future, formally endorses project plans and budgets for all major future IT projects before the plans are implemented.**
- 2. That future information technology projects involving multiple business groups within DoJ and/or other agencies have a senior representative (such as the Deputy Secretary) appointed to their steering committee.**

7.4 Was the project adequately implemented?

In assessing whether the GIMS project was adequately implemented, we examined if:

- user's requirements were adequately analysed and defined
- a communications network was developed for participating agencies to access the software
- the software was tested and staff were trained to use it
- data from old systems and records was correctly transferred to the new database
- appropriate security and control processes were developed and implemented.

DoJ expected that user requirements would be mostly common to all participating agencies, but that agencies would also have a small number of specific requirements.

User requirements were defined at workshops between the contractor and representatives of participating agencies and documented in a *Business Solution Design* document. This document described the user requirements of the system, and was approved by all participating agencies in November 2002.

The *Business Solution Design* document did not provide in-depth detail of the users' requirements for all agencies and the DoJ business groups, and was only used by Victoria Police. The CFA, Corrections Victoria and the Courts prepared further business solution designs, with greater detail than the initial document. The business solution design for Corrections Victoria was approved in November 2003.

A key reason for CFA preparing a further business solution design document was that it decided to replace its existing job costing software with the GIMS software. This required the software to be used by all its business units, not just those responsible for asset management. CFA consulted users during the development of its business solution design, but did not have it formally approved by users. CFA told us they believed a full review of the complete document would have further delayed the project and incurred more costs. CFA's Project Director approved the business solution design in December 2003.

It took 6 months for the business solution design document for the Courts to be approved by all relevant parties. The document was finally approved in July 2004.

VicSES prepared a business solution design but withdrew from the project (due to resource constraints) before it was approved. At the time of our audit, the GIMS project manager was negotiating with VicSES about approval of its business solutions design.

It took agencies between 12 months and 18 months to develop more detailed business solutions designs, after the initial design was approved in November 2002. The reasons given for this length of time were that:

- CFA implemented a new financial management system between December 2001 and July 2002, which required it to take staff off the GIMS project until the system was fully established
- the DoJ finance group upgraded its financial systems in 2002 and was unable to allocate resources during this time to define the interface requirements between the GIMS software and their financial management systems, which had to be included in the business solutions design
- the business solution design documentation had to be revisited to include detail requirements that met user needs.

The GIMS project aimed to provide the information and tools to monitor and benchmark the asset management performance of participating agencies. This would require common approaches and procedures by all agencies and, in particular, a common approach to user requirements (as was envisaged in the original business solutions design). This has not occurred. Each agency is using the software to record different types of assets and costs. For example, Victoria Police only uses the software's asset maintenance module for buildings and firearms, whereas the CFA uses it for all its plant and equipment. The status of each participant's implementation is presented later in the report.

The GIMS project established a communications network between participating agencies. Victoria Police and the CFA both operate their own separate computer networks, however they have established linkages with the GIMS network. There was a 7½ month delay establishing the communications network, mainly due to:

- underestimation of the complexity of providing secure access to the GIMS software for participating agencies
- participating agencies being unable to agree on technical aspects of the network
- difficulties coordinating participating agencies and their information technology providers.

The GIMS application software was tested to ensure that it met the requirements of all participating agencies. Staff were also trained to use the software, before it was made available.

Victoria Police was the first agency to use the software, starting in June 2003. CFA and Corrections Victoria started using the software in June 2004 and October 2004, respectively. After each agency implemented the software at their sites, the agencies already using the software were required to test it again. This has resulted in more testing than originally envisaged.

All participating agencies transferred data from their old systems and manual records (such as databases, financial systems, physical stock-takes and manual records) to the new database. At the time of the audit, Victoria Police was checking its GIMS database records of assets against information about the same assets held in another system², despite having implemented GIMS (asset management module) 14 months earlier. Further, at the time of the audit, no participating agency had checked their GIMS database records against records in their financial systems. CFA told us that it planned to do so in future.

Security policies and procedures were developed for the GIMS project by the project team, but at the time of the audit, were not formally endorsed by it. Our audit identified some scope for security improvements, including to password controls and monitoring of security activity. DoJ plans to modify the GIMS software to improve security.

The security of the inter-agency GIMS communications network has not been independently reviewed.

As part of the GIMS project, agencies developed interfaces to their financial management software. However, at the time of the audit, procedures had not been developed to reconcile the data in the GIMS database and the data in their financial systems.

Conclusion

Although one agency implemented the GIMS software over 18 months ago, security policies and procedures for the GIMS software were not yet finalised.

The lack of reconciliations between the data held in GIMS and agency finance systems may affect the integrity of GIMS data and represents a missed opportunity to ensure integrity between the 2 systems.

Victoria Police should have checked the GIMS database records of its assets against information about the same assets held in other relevant systems as part of its GIMS implementation.

² The Licence and Registration System (LARS), which records details of all Victorian registered firearms.

Recommendations

3. **That all participating agencies and business groups regularly check their GIMS database records against their financial systems records.**
4. **That DoJ formally endorse and implement the security policies and procedures for the GIMS software.**
5. **That DoJ facilitate an independent security review over the inter-agency GIMS communications network.**

7.5 Was the project adequately managed?

In assessing whether the project was adequately managed, we examined if:

- the status of the project was regularly reported and monitored
- risks were identified and managed
- budgets were established and costs managed
- the project was on time
- an independent quality assurance process was established
- there was a post-implementation review.

We found that the project manager prepared regular progress reports for the Project Executive Steering Committee. However:

- progress reports, until the appointment of the current project manager in June 2004, did not track project costs
- while project reports did identify risks, there were no detailed mitigation actions, no timeframes or people responsible for the mitigation actions.

The project charter, implementation plan and early project reports identified several risks. These included:

- several projects being run concurrently at the department and Victoria Police, which could delay the GIMS project
- the computer system security and other technical arrangements of each participating agency needed to be changed, which could take considerable time and delay project implementation
- coordination issues with the third party information technology managers of DoJ and Victoria Police.

Each of these risks eventuated during the project. However, the new project manager, as from June 2004, maintained a risk register, which includes mitigation strategies.

DoJ originally planned for the GIMS software to be in use by Victoria Police by November 2002, and in use by all other participating agencies and business groups by 21 January 2003. Figure 7A shows the extent of implementation of the 3 GIMS software modules, at February 2005.

FIGURE 7A: GIMS PROJECT IMPLEMENTATION STATUS

Agency/Business Group	Asset and equipment maintenance and scheduling (a)	Management of capital construction projects (a)	Tenancy lease management	Number of users
Victoria Police	Completed December 2003 (b)	Completed June 2003	Completed June 2003	35
CFA	Completed February 2005 (b)	Completed February 2005	Not applicable	255
Corrections Victoria (DoJ business group)	4 out of 11 prisons, at February 2005	Not yet implemented	Not yet implemented	14
Courts (DoJ business group)	Not yet implemented	Not yet implemented	Not yet implemented	0
VicSES (DoJ business group)	Not yet implemented	Not yet implemented	Not yet implemented	0

(a) These 2 modules form part of the asset and project management software product.

(b) Victoria Police only uses the asset and equipment maintenance module for buildings and firearms, whereas the CFA uses it for all its plant and equipment.

DoJ now plans for all participating agencies and the DoJ business groups to have implemented the 3 GIMS modules by July 2005 (except VicSES, for which there is no scheduled date at the time of our audit).

In February 2002, before the implementation of GIMS commenced, the contractor's fees were approved by DoJ. Other project costs such as hardware, reporting tools and support were approved throughout the project, as required. However, as stated previously in this report, a detailed budget outlining all expected costs was not prepared and approved at the start of the project by the Project Executive Steering Committee. Figure 7B shows project costs incurred by DoJ to 31 December 2004, as identified by this audit.

FIGURE 7B: GIMS PROJECT COSTS INCURRED BY DoJ, TO 31 DECEMBER 2004

Item	(\$'000)
Contractor fees (for software licensing and implementation)	3 891
DoJ costs (including project staff costs)	2 592
Computer hardware training, facilities management, support, reporting tools and other items	1 505
Total	7 988

At the date of preparing this report, the total estimated cost of completing the project at DoJ was \$9.2 million.

As well, project costs to 31 December 2004 for the CFA were \$1 million and for Victoria Police were \$370 000.

At the time of the audit, DoJ was paying for software support and maintenance. However, because the software is yet to be implemented fully across all the agencies, they are not enjoying the full benefits of this support and maintenance.

There was no independent quality assurance process established over the project, as required by the project implementation plan.

At the time of the audit, the project steering committee was reviewing the ongoing management arrangements for the GIMS software. The Office of the Chief Information Officer (of the Department of Premier and Cabinet) had also commenced a review to assess whether the GIMS software would meet the needs of all public sector agencies. However, no review of the participating agencies' implementation of GIMS software (which was completed in some agencies) was conducted.

Conclusion

The GIMS project timeframes, risks and budgets were not adequately managed.

Recommendations

6. **That DoJ regularly monitor and report on expenditure on major projects against a project budget.**
 7. **That DoJ ensure that the quality of every major project is independently assured.**
 8. **That DoJ conduct a post implementation review of the GIMS project.**
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8. Construction of the Yalmy Road fire control line



8.1 Audit conclusions

During February 2003, as part of an effort to extinguish one of the largest wildfires ever experienced in Victoria, the Department of Sustainability and Environment (DSE) constructed a fire control line along Yalmy Road in East Gippsland. We acknowledge the extraordinary circumstances associated with these fires, and the considerable time and resourcing pressures placed on DSE during this time.

The primary objective of DSE's effort was to limit the impact of the fires on life, property and community assets. Despite this, deficiencies in the planning and management of the control line compromised DSE's fire suppression effort. Trees representing a high fire hazard were not removed, while trees representing a low fire hazard, but containing high quality timber, were removed from the control line. Pushing trees and vegetation up against the forest wall also created a fire hazard that threatened the safety of firefighters.

In constructing the control line, DSE failed to comply with a number of legislative requirements and its forestry/fire management codes of practice. The most significant breach involved the taking of wood from the Snowy River National Park for commercial use, which is not permitted under the *National Parks Act 1975*. DSE also failed to properly supervise, accurately record and check the timber salvaged.

An internal investigation into the management of the fire control line, conducted jointly by DSE and Parks Victoria, went to considerable effort to establish a sound basis for sampling forest plots in order to determine the volume of timber taken from the site. However, by not establishing whether logs had been removed from the trees that had been "pushed over"¹, it was not possible to determine what timber was taken from the site. Consequently, we were not able to determine whether appropriate royalties had been paid to DSE for all timber removed from the control line.

Allowing a key logging industry figure to play a lead role in the construction of the control line, created a clear conflict of interest. It was not possible for us to determine whether this situation directly influenced any operational decisions taken on the construction of the control line. However, it was clear that the manner in which much of the control line was constructed varied from normal practice and provided benefits to the logging industry.

¹ This refers to trees that were left where they were felled and not to trees pushed into windrows.

The internal investigation made several recommendations to help improve the management of similar fire suppression efforts in future. DSE has taken appropriate action to address these recommendations.

RESPONSE provided by the Acting Secretary, Department of Sustainability and Environment

In general, I agree with the comments and conclusions throughout the report, and I note that many of these comments were previously identified by the DSE internal investigation. However, the following specific comments are provided in relation to the conclusions:

- The DSE internal investigation report indicates that the fire suppression effort was only potentially compromised. This conclusion was on the basis that the works did not impact on other fire suppression activities and the fact that the fire never reached the control line.*
- In the initial stages of the construction of the control line there was inadequate supervision. The logs removed from the control line were subjected to the normal DSE recording process (i.e. log docket), however the further step of random comparisons of log docket with actual logs (at the mill) did not take place due to staff involvement in fire suppression activities.*
- The construction of the control line occurred during abnormal circumstances where Victoria was experiencing severe bushfires following several years of drought and normal fire suppression tactics were not succeeding. The construction of the Yalmy control line was intended to be for fire suppression purposes. It was never intended to be a logging operation.*

I am very pleased to note that you "... are satisfied that DSE has taken appropriate action to address the recommendations made by the internal investigation".

I note and agree with the 2 recommendations contained within your report. However, I reserve the right to withhold the publication of reports, which may be of a sensitive nature.

I confirm that all of the recommendations of the DSE internal investigation report are being implemented as part of our training for this fire season.

RESPONSE provided by Chief Executive, Parks Victoria

Parks Victoria's primary interest is to ensure that the actions undertaken in fire suppression are consistent with the National Parks Act. Parks Victoria generally supports the comments and conclusions of the report. Parks Victoria's comments on the report are consistent with those expressed by DSE in its response to the report.

8.2 Background

As part of an effort to extinguish one of the largest wildfires ever experienced in Victoria, between 2 February and 25 February 2003 the Department of Sustainability and Environment (DSE) constructed a fire control line along Yalmy Road. The control line generally followed the Yalmy Road and the ridgeline between the Snowy River National Park and state forest, and covered a distance of 42 kilometres. Approximately 61 per cent of the control line was in national park areas while 39 per cent was within state forests.



Aerial view of Yalmy Road control line, showing merchantable timber removed from the control line and prepared sawlogs stacked along the roadside.



Typical (normal) control line, where a 10-metre wide strip of vegetation is flattened and trees are left standing.

The construction of the control line was undertaken in extraordinary circumstances, including the following:

- *Seasonal conditions:* Victoria had received below average rainfall for several years prior to the 2002-03 fire season. Drought conditions prevailed throughout the state and these abnormally dry conditions, in conjunction with low fuel moisture content, created the potential for extreme fire conditions and behaviour.
- *2002-03 fire season:* Several large fires occurred in Gippsland during December 2002 which meant that some staff from that region were almost continually involved in fire suppression, right through to their involvement in the alpine fires (that is, some 4 months involvement in continuous firefighting). In early January 2003, lightning caused 84 fires in the north-east of the state. The majority of these fires were extinguished, but the remainder joined and moved into East Gippsland. By the time they were extinguished, these fires had burnt in excess of 1.5 million hectares.
- *Fire behaviour:* The fires spread rapidly into Gippsland and firefighters were experiencing both extreme and erratic fire behaviour, to the point where conventional control lines were continually being breached by the fire.

- *Resource impacts:* The extent and duration of these fires put a strain on available resources. Resources were called in from interstate and overseas, not only to physically assist, but also to relieve key management personnel who had been working extended hours for a number of weeks. Particular pressure was placed on Victoria's limited number of appropriately accredited incident controllers. Further, the size and complexity of the fires was something that many staff had not experienced before.

DSE's strategy was to prevent the alpine bushfires progressing beyond Yalmy Road. To do this, DSE intended to back-burn forest to the Yalmy control line, to create a 5-kilometre-wide area where vegetation fuel loads would be reduced to a minimum. DSE hoped that this 5-kilometre buffer would deprive the oncoming fires of fuel and enable it to extinguish them.

If the fire passed this control line, it was expected to travel unhindered to the east and south, threatening the East Gippsland forest resource, private properties, towns and communities. At the time control line works commenced, the fire was expected to reach Yalmy Road in 10 days, although if weather conditions changed, DSE believed it could have reached it in one day.

To improve the chances of controlling the proposed back-burn, DSE decided to remove high fire hazard trees (mainly the fibrous-barked Messmate Gums and trees with hollows) from the control line. An impromptu decision was also made at the local level during the construction of the control line, to salvage "all merchantable timber" that was felled or pushed over².

In constructing the control line, logs were taken from the Snowy River National Park and processed at local sawmills in contravention of the requirements of the *National Parks Act 1975*. It was the first time in Victoria's fire experience that sawlogs were salvaged as part of DSE's fire control/suppression activities.

On 21 February 2003, following a direction from DSE, no further logs were removed from the control line and DSE and Parks Victoria jointly established an internal investigation into the planning, supervision and operation of the control line. The internal investigation reported to the Minister for Environment, the Secretary of DSE and DSE's Chief Fire Officer in August 2003. At the date of preparing this report, the full investigation report had not been made public, but a summary of its major findings was made available in September 2004.

² This decision was reflected in the Yalmy control line "prescriptions" for 8, 10, 12 and 14 February 2003. Prescriptions outline the work to be undertaken in the construction of a fire control line.

Based on the information gathered by the internal investigation team, the felled trees on the control line contained around 7 690 cubic metres of sawlog material, of which about 1 977 cubic metres was received by sawmills and 5 713 cubic metres left on the site (including both prepared sawlogs and unprepared timber). A total of \$114 000 in royalties was eventually collected by the state for the timber salvaged from the fire control line.

8.3 Audit purpose and scope

In January 2004, we received an allegation from a member of the public that timber with a market value of \$1 million had been stolen from the Yalmy Road fire control line. Given the severity of this allegation and the public interest in the subject matter, we decided to investigate the claim.

The key objectives of the audit were to determine whether:

- all timber taken from the control line had been properly accounted for
- the construction of the control line represented good fire suppression practice, and complied with the relevant legislative requirements and codes of practice
- any actual or potential conflicts of interest arose for key individuals involved in the construction of the control line, and whether these impacted on decisions taken in relation to this operation
- DSE and Parks Victoria have taken action on the recommendations made by the internal investigation.

Our audit examined information gathered by the internal investigation into the construction of the control line and included discussions with relevant agency staff.

8.4 Results of DSE's internal investigation

In early 2003, DSE commenced its internal investigation of the Yalmy Road control line. The purpose of the investigation was to:

- review the circumstances in which timber had been removed from the national park
- initiate measures to ensure all wood taken from the national park was accounted for, and the remaining timber was used for park management purposes
- evaluate whether works undertaken were appropriate, were conducted as planned and whether fire protection objectives were achieved.

The investigation included:

- An examination of the sawmill log delivery dockets to account for timber received at sawmills. This examination identified that 1 977 cubic metres of merchantable sawlog removed from the construction of the Yalmy control line was sent to East Gippsland sawmills.
- An inventory of wood cut and remaining on the control line. This process identified that, on 21 February 2003 when all logging ceased, 2 113 cubic metres of prepared sawlog remained on the Yalmy control line. One hundred and eighty cubic metres of this timber was marked "PV" (Parks Victoria) to indicate it was extracted from the national park.
- A survey to determine the type and quantity of timber removed from the control line.

The forest inventory process involved an examination of thirty-three, 265 square metre plots of forest on the control line, to obtain details such as the number and type of trees left standing, wood pushed into windrows, the number of cut stumps and trees pushed over, the width of the control line and percentage of the control line in the national park. The investigation team also assessed the extent to which trees represented a fire hazard and their merchantability.

The area examined in the investigation amounted to 5 per cent of the total area of the control line. The investigation team used data from its samples to extrapolate information in relation to the entire control line. The extrapolation process implicitly adopted had a 7.7 per cent margin of error (at a 95 per cent confidence level).

The investigation team also:

- reviewed all documentation pertaining to the preparation of the control line
- interviewed key staff within the Incident Management Team (IMT)³ at Orbost and the Incident Multi-Agency Co-ordination Centre (IMACC)⁴ at Traralgon, and the staff supervising work on the Yalmy control line
- reviewed site and photographic evidence
- established a detailed chronological sequence of the events, people and decisions leading up to, and including, the preparation of the Yalmy control line.

³ The IMT is responsible for developing fire suppression plans and managing firefighting activities at the local level.

⁴ The IMACC is responsible for regional coordination of firefighting activities.

The key findings of the internal investigation were that:

- not all timber from the national park was labelled as required by DSE and some was unlawfully taken and used for commercial purposes
- the removal of merchantable timber did not contribute to the fire suppression effort and potentially compromised the intended purpose of the control line, which was to contain the fire and stop its spread
- notwithstanding the merits or otherwise of pursuing a back-burning strategy off Yalmy Road, the “prescriptions” prepared for the track preparation were generally appropriate for such a strategy
- some relevant codes of practice and legislation were contravened during the preparation of the control line.

While the internal investigation established that the decision to salvage logs from the control line was approved by the Orbost IMT, it was unable to determine beyond reasonable doubt which departmental officer made the decision to remove and commercially use timber from the national park⁵.

The investigation focused on ensuring that wood removed from the national park was fully accounted for, and that the timber was used for park management purposes only. Accounting for all timber taken from the construction of the control line was not an objective of the investigation (although the investigation team’s sample covered both the national park and the state forest areas). Accordingly, the report did not form any view on whether all timber on the control line had been accounted for.

A summary of the investigation’s findings was not publicly released until some 12 months after its completion.

Recommendation

- 1. That, in future, DSE publicly releases the findings of major investigations dealing with issues of public interest, on a timely basis.**

RESPONSE provided by the Acting Secretary, Department of Sustainability and Environment

Agree. However, DSE reserves the right to withhold the publication of reports which may be of a sensitive nature.

⁵ The decision to salvage logs from the control line was first formally approved at IMT level on the evening of 10 February 2003, almost 2 days after logging operations had commenced on the control line. There were no other department approvals, either sought by the Orbost IMT or found by the internal investigation.

8.5 Accounting for the timber salvaged from the Yalmy control line

As the sample plots examined in detail by the investigation team represented around 5 per cent of the total area of the control line, information generated from these plots was multiplied by 20 to provide an estimation of the situation on the control line.

When estimating the volume of timber generated from stumps identified on the site, it was assumed that each tree produced one log and each log contained 2 m³ of timber. While the number of sawlogs generated from each tree is dependent on the height of each tree, given the height of the surrounding trees in the national park, DSE considered this assumption to provide a conservative estimation of the wood likely to be generated from trees logged.

The internal investigation also identified the volume of timber taken from the site and processed at sawmills, and estimated the volume of sawlogs which remained on the control line. This information is outlined in Figure 8A.

FIGURE 8A: RECONCILIATION OF THE ESTIMATED VOLUME OF TIMBER FELLED TO THAT ACCOUNTED FOR

	Number of trees in samples	Estimated total trees on the control line	Estimate of timber felled	Timber processed and timber prepared on site - volume (m ³)
Recorded on log delivery dockets	n.a.	n.a.		(a) 1 977
Prepared logs on the control line	n.a.	n.a.		(b) 2 113
Stumps counted	104	2 080	4 160	
Trees pushed over (c)	50	1 000	(d) 2 000	
Total			6 160	4 090

- (a) As all but 3 of the 69 loads of sawlogs delivered to the sawmills from Yalmy Road had been sawn at the time the internal investigation team visited the sawmills, they were unable to physically verify that this was in fact the volume of wood delivered to the mills.
- (b) Around 1 940 cubic metres of these logs were taken to sawmills for processing, with royalties on these logs paid to Parks Victoria. The remaining logs could not be salvaged as the timber had deteriorated.
- (c) Excludes timber pushed into windrows.
- (d) It is likely that most of the timber felled from trees pushed over, remained on the control line and, therefore, is accounted for. Accordingly, care needs to be taken in interpreting the totals presented in the table.

n.a. Actual figures used.

Source: DSE internal investigation.

From Figure 8A, it can be seen that the estimated volume of timber felled (excluding timber in windows) was 6 160 m³, of which 4 090 m³ were prepared and left on site or transferred to sawmills.

The investigation team noted that some trees had been cut before being pushed. The team indicated that the reason for cutting these trees would have been to either enable the trees to be pushed over or to extract sawlogs. However, the team did not attempt to determine the number of trees pushed over that had been cut before being pushed and, whether or not the logs cut from these trees remained on site or had been removed.

Conclusion

The internal investigation went to considerable effort to establish a sound basis for sampling plots along the control line, and to identify and document, in detail, the situation in regard to each sample plot. However, by not attempting to determine which trees pushed over had logs removed, they were unable to account for all the timber on the site. This additional step would not have added greatly to the investigation team's workload as the team only identified 50 trees that had been pushed over.

Due to this deficiency in the investigation process, we are unable to determine whether or not timber had been illegally taken from the site.

RESPONSE provided by the Acting Secretary, Department of Sustainability and Environment

The audit comment that the additional step of determining which trees pushed over had logs removed would not have added greatly to the investigation team's workload, does not take into account the practical problems associated with matching a prepared log to a stump. It also ignores the context in which the investigation took place, namely, one of Victoria's largest wildfires, time restrictions due to the threat of the approaching fire, limited resources, unpredictable fire behaviour etc.

Recommendation

- 2. That future investigations be better planned to ensure that sufficient evidence is gathered to enable as firm as possible conclusions to be drawn from the data available.**

RESPONSE provided by the Acting Secretary, Department of Sustainability and Environment

Agree. However, the internal investigation gathered sufficient information to make meaningful recommendations to limit the possibility of a recurrence and, in doing so, met its terms of reference. Given the magnitude of the task, it was not realistic to survey the entire control line to the extent implied by this recommendation.

8.6 Grading of sawlogs received at the sawmills

Royalties on timber taken from state forests are payable to the state according to the quality (grade) and volume of logs harvested.

We assessed whether the royalties received by the state from timber taken from the control line were reasonable, based on the type of timber expected to be extracted from the control line. Figure 8B shows:

- the types (grades) and proportions of timber expected to be produced from state forests in the Yalmy Road area (based on previous harvesting in the area)⁶, and the royalties that would have been received on this mix of timber
- the volumes and grades of timber recorded by sawmills receiving timber from the control line, and the royalties paid on this timber.

FIGURE 8B: ROYALTIES AND EXPECTED LOG GRADE DISTRIBUTION FOR THE YALMY FOREST BLOCK, COMPARED WITH LOGS RECORDED BY SAWMILLS

Log grade and royalty	Sent to sawmills	Log grade distribution	Royalty paid	Expected log grade distribution	Expected royalty
(\$ per m ³)	(m ³)	(%)	(\$)	(%)	(\$)
A 68	-	-	-	3	4 012
B 40	7.85	0.4	267	9	7 081
C 27	1 385.64	70.4	33 523	70	37 173
D 12	498.31	25.4	6 025	18	4 248
E 7	75.26	3.8	549	-	-
Waste	10.00	-	n.a.	-	-
Total	1 977.06	100	40 364	100	52 514

Note: Royalty figures are an average, rounded to the nearest dollar. The rates for particular grades vary depending on species, size class and cartage zone. They include GST, but not the Timber Promotion Council levy. The expected grade distribution figures are based on data for the Yalmy forest area.

⁶ The log grade distribution is based on 5 040 m³ of sawlogs harvested from the Yalmy forest block in East Gippsland during 2002-03. While there are some limitations in using this data to extrapolate the likely timber grade distribution across the control line, the data nevertheless provides the likely distribution (based on the best available information).

Based on information generated from sawlogs harvested in surrounding forests, it would be expected that 12 per cent of the timber from the control line would be "A" and "B" grade timber. However, the wood taken from the control line and graded at the sawmills contained no "A" grade and virtually no "B" grade.

One explanation for the above variance is that there was a downgrading of logs, in that "A" and "B" grade logs taken from the control line were classified as "C" grade and "C" grade logs were classified as "D". This scenario was supported by the investigation team's inspection of the control line, which identified a number of Mountain Ash tree stumps on the site. Mountain Ash is a highly valued timber, with good saw logs likely to receive an "A" grading.

The internal investigation also determined that no Mountain Ash was recorded at the sawmills and all of the timber from these trees could not be accounted for from sawlogs left on the site or in timber pushed into windrows.

Royalties paid on the 1 977 cubic metres of timber taken to sawmills amounted to approximately \$40 000. If the distribution of log grades expected from forests around Yalmy Road were reflected in the timber taken from the control line, the state would have received around \$12 000 in additional royalties.

Conclusion

Based on the average grades assigned to sawlogs received at sawmills from timber harvested in the Yalmy Road area, there is some doubt as to the accuracy of the grades assigned to some logs taken from the control line.

RESPONSE provided by the Acting Secretary, Department of Sustainability and Environment

The expected percentages shown in column 5 of the above table are derived from a small sample of approximately 5 000 m³ in one year, and probably from one logging coupe in the Yalmy Block. Logging coupes are chosen for the availability of commercial quantities of logs. However, the yield from each coupe varies depending on factors such as elevation, aspect and logging history. The data from the Yalmy Forest Block may not provide an accurate indication of the yield over the entire length of the Yalmy Control Line. The control line followed the path of the road and it is probable that logs have also been extracted from the surrounding bush when the road was originally constructed. Such practice is not unusual. It may have been more accurate to use the grade distribution of the prepared logs left on the control line.

RESPONSE provided by the Acting Secretary, Department of Sustainability and Environment - continued

While it is agreed that mountain ash is a highly valued timber, with good saw logs likely to receive an "A" grading, mountain ash can also produce "C" grade logs. While the internal investigation revealed that mountain ash had been removed, the logs were not checked by DSE staff and, thus, the actual grade of these logs is uncertain. On this basis, it is difficult to conclude or infer that the mountain ash logs were all "A" grade.

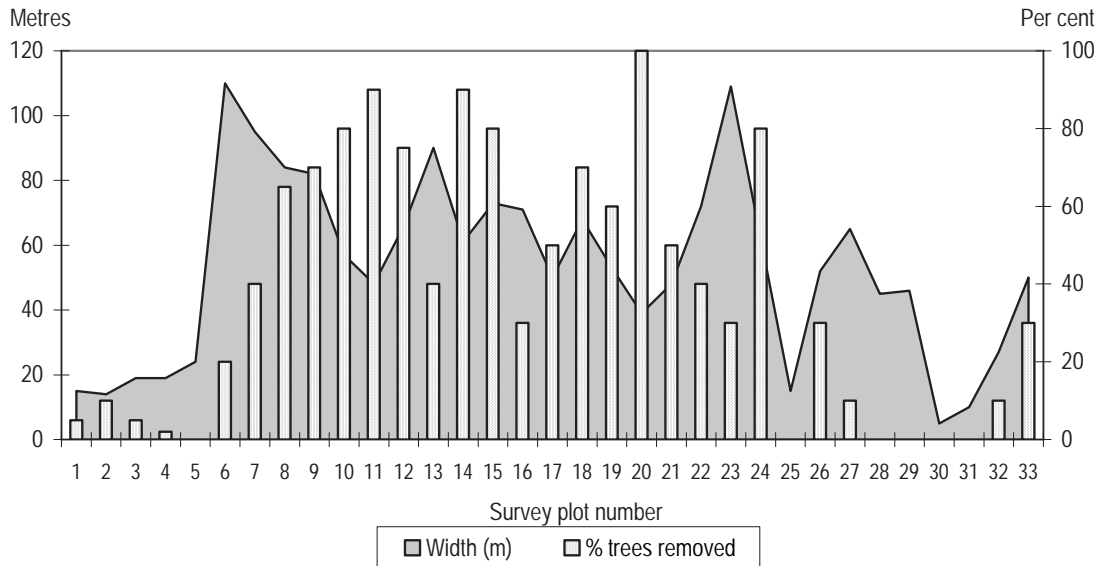
8.7 Construction of the control line and good fire suppression practice

The work that needs to be undertaken in the construction of a fire control line is outlined in a document known as a "prescription," which is prepared by Fire Incident Management Teams.

Normally, this work involves the flattening or removal (scalping) of vegetation over a 10-metre-wide strip of land to reduce fuel loads. However, in the case of the Yalmy Road control line, it was decided to remove high fire hazard trees from the control line to improve its effectiveness. This involved the removal of trees with fibrous bark, hollows or a dry side. The decision to remove high fire hazard trees was based on advice received from firefighting specialists engaged by DSE.

The Yalmy Road control line had an average width of 53 metres, and covered approximately 70 hectares of state forest and 110 hectares of national park. The works undertaken were extensive, with around 38 per cent of trees felled. Figure 8C shows the width and proportion of trees felled in each of the 33 sample plots examined by the internal investigation team.

FIGURE 8C: WIDTH OF THE YALMY CONTROL LINE AND PROPORTION OF TREES FELLED



Source: Report on the internal investigation into the Yalmy control line, DSE.

The internal investigation showed that the approved prescriptions were not followed for the majority of the control line. The information gathered by the investigation team also indicates that the extraction of merchantable timber from many segments of the control line was not related to the achievement of DSE’s fire prevention objective. For example:

- trees with a high fire hazard such as messmate, stag (dead) trees and trees with hollows, but not containing any merchantable timber, were not removed. The internal investigation estimated that 1 880 such trees remained standing on the control line
- 1 080 trees classified as a low fire hazard were removed from the control line
- many more trees were removed than required by the prescriptions. For example, along 18 kilometres of the control line, 61 per cent of trees were removed, despite the average percentage of stringy bark species (higher fire hazard tree) in the surrounding forest being only 40 per cent
- the forest, in some parts of the control line, was almost clear-felled
- according to observations made by the investigation team, the width of the control line appeared to vary according to the quality of the sawlog material present in the surrounding forest.



Yalmy control line, showing a high fire hazard "dead" tree still standing (arrowed), while low fire hazard trees have been removed.

The internal investigation also noted that the way in which the control line was constructed resulted in a large volume of waste material that was pushed into windrows, which created an additional fire hazard.

Conclusion

DSE's decision to salvage timber from the Yalmy fire control line compromised its fire suppression effort. Trees with a high fire hazard were not removed, while trees with a low fire hazard but containing high quality timber, were removed. Windrows of vegetation created by logging operations created a fire hazard that threatened the safety of firefighters. Additional resources were required to make the fireside windrow safe for DSE's back-burning operation.

RESPONSE provided by the Acting Secretary, Department of Sustainability and Environment

There was no evidence found by the internal investigation to support this conclusion. The DSE internal investigation report indicates that the fire suppression effort was potentially compromised. This conclusion was reached on the basis that the works did not impact on other fire suppression activities and the fact that the fire never reached the control line.



Yalmy control line, showing burnt windrow on left of photo.

8.8 Logging in the national park

Once it became known that timber had been removed from the national park for commercial use, the Acting Premier directed that the timber from all trees felled in the park be marked and only used for park purposes.

The DSE internal investigation found that:

- sawlogs had been produced from trees in the Snowy River National Park and removed from the park. As there is no power in the *National Parks Act 1975* for wood to be removed from a national park, the cutting and commercial use of park timber represented an inappropriate act
- logs from the national park continued to be left unmarked even after logging crews had been specifically instructed that all sawlogs prepared from timber taken from the national park were to be identified by the letters "PV" (Parks Victoria)
- control line works commenced without any assessment of the impact of these works on the natural/cultural value of the park.

In order for DSE to ensure that an appropriate share of the logs taken from the control line were allocated for park purposes, it deemed that all sawlogs remaining on the site at the time of the internal investigation had originated from the national park. The proceeds of the sale of this forest produce were placed in a trust fund for Parks Victoria purposes.

The internal investigation could not determine the amount of timber taken from the national park, as the sawlogs prepared had not been marked and were mixed with loads taken from the state forest. Furthermore, it did not find any direct evidence to identify which particular logs were taken from the park or where those logs were eventually taken. In these circumstances, it was not possible to pursue any legal proceedings against those individuals who had taken the logs without authority.

Further, analysis undertaken by the investigation team disclosed that the sawlogs left on the Yalmy control line were of a lower quality than the sawlogs delivered to the sawmills of East Gippsland.

Figure 8D outlines the expected distribution of log grades for the Yalmy Road area and the wood remaining on the control line marked "PV" (i.e. wood taken from the national park). Figure 8D highlights a considerable discrepancy between the grading of wood expected, and the wood tagged as national park timber.

FIGURE 8D: LOG GRADES OF STATE FOREST TIMBER COMPARED WITH LOG GRADES OF NATIONAL PARKS TIMBER

Log grade	Expected state forest log grades (a)	National park "PV" log grades (b)
	(%)	(%)
A	3	-
B	9	-
C	70	58.9
D	18	41.1
E	-	-

(a) The state forest log grade distribution is based on 2002-03 data for the East Gippsland Yalmy forest block (excluding logs from the Yalmy control line).

(b) The national park log grades are in relation to the 180 m³ of logs marked "PV".

Source: Report on the Internal Investigation into the Yalmy Control Line, DSE.

Conclusion

The action of taking wood from the national park for commercial use was inappropriate and breached the requirements of the *National Parks Act 1975*. In addition, as indicated in the internal investigation report, it is likely that lower quality wood from the state forest was used to substitute for the higher quality wood taken from the park.

8.9 Conflict of interest

Once a fire has been discovered on or near crown land, firefighting crews are alerted and resources are assembled to fight and put out the fire. If the initial attempts to extinguish the fire fail, a formal incident management team is established by DSE. Such a team consists of:

- an incident controller, responsible for the overall management of a fire
- a planning officer, responsible for developing an incident action plan and prescriptions
- an operations officer, responsible for implementing the incident strategies
- a logistics officer, responsible for provision of facilities, services and materials.

In January 2002, a former senior executive of DSE was one of a number of ex-departmental employees who were engaged by DSE to provide strategic advice in relation to the firefighting activities. When logging works on the Yalmy control line commenced on 9 February 2003, this individual (although not part of the formal incident management team) developed the control line strategy and oversaw its implementation.

His detailed local knowledge of East Gippsland's private and public resources made him appropriately qualified for the position of strategic advisor. At the time he was engaged by DSE, he was also employed as the chief executive officer of a hardwood logging company that worked for a syndicate of sawmills in East Gippsland.

Interviews conducted by the internal investigation team, with DSE staff and individuals working on the control, indicated that:

- the role of this individual was never properly explained to incident management team members
- his unrestricted movement between planning, operational and supervisory roles was never queried. He not only authored the original prescriptions for the Yalmy control line (e.g. to remove all merchantable timber), but also supervised its implementation to the extent of marking trees for removal on a visit to the control line
- he engaged other individuals from the logging industry to supervise construction of the control line, instructed them on the work to be undertaken and monitored their progress. This arrangement resulted in supervisors reporting to someone managing the control line for DSE, who was their employer under normal circumstances.

The roles and functions performed by this individual put him in a situation where he had a clear conflict of interest, as his company and the industry in which he worked stood to benefit from decisions he made regarding the construction of the control line. The contract between DSE and this individual was terminated on 14 February 2004, due to this conflict of interest.

Conclusion

Allowing a key timber industry figure to play a lead role in the construction of the control line created a clear conflict of interest. It was not possible for us to determine whether this situation directly influenced any operational decisions taken on the construction of the control line. However, it was clear that the manner in which much of the control line was constructed varied from normal practice (in that, it involved the taking of a significant volume of timber from the control line) and provided significant benefits to the logging industry.

8.10 Compliance with legislation and codes of practice

As previously indicated in this report, DSE's management of the control line resulted in a number of breaches of legislation and its own codes of practice, governing good forestry/fire management in Victoria. Details of the specific breaches are outlined below:

National Parks Act 1975

- Trees were harvested from a national park for commercial purposes. There is no power granted to either DSE's secretary or the minister under the National Park Act to allow the extraction of forest produce from the Snowy River National Park.

Forests Act 1958

- There are no ministerial powers in the Forests Act to allow the removal of forest produce from a national park. Section 62(2) of this Act, however, allows the secretary to authorize the removal of timber from a national park, if this was done either for fire protection or fire suppression purposes. The removal of forest produce from the Yalmy control line was not considered by the internal investigation team to contribute to DSE's fire suppression effort.

Accident Compensation (Occupational Health and Safety) Act 1996

- The method of construction of the control line compromised firefighter safety by creating a continuous windrow of forest vegetation, which would have restricted access and escape routes to and from the back-burning operations that were to be conducted in the national park.

Code of Practice for Fire Management on Public Land

- The creation of windrows of vegetation and soil.
- The disturbance to soil and vegetation was not minimised.
- The control line was constructed along a ridgeline, that is, an area known to be of high visual value.

Code of Practice for Safety in Forest Operations

Anecdotal evidence suggests that:

- Safety signs were not displayed where falling and snagging operations were underway.
- Machine operators were working alone.
- Signs were not displayed warning people to keep clear of the log dump area.

Code of Practice for Timber Production

- Wood utilisation plans and coupe plans were not prepared in advance of the logging operation.
- Landscape values were not taken into account.
- Environmental care principles had not been observed.
- Forest material had been pushed into natural drainage lines.

Non-compliance with prescriptions, directions and guidelines

- Inappropriate removal of trees, such as those with a low fire hazard (e.g. mature Alpine Ash, Shining Gum; Grey Gum, Silvertop).
- Removal of more trees than required by DSE's prescription, including one tree in the national park that was of historical significance.
- Non-removal of trees that were identified in the prescriptions as a fire hazard (e.g. stag trees, hollow trees, Messmate Gums - there were 1 880 such trees still on the Yalmy control line identified by the internal investigation).
- Clearing of vegetation to mineral earth for the entire length and width of the Yalmy control line, rather than the prescribed requirement of minimal soil disturbance and flattening or rolling the forest understorey, with clearing around Messmate Gum trees only.
- Failure to identify all sawlogs produced from trees taken from the national park.
- The species of some trees were falsely represented on DSE log docketts.

Code of Practice for Workplaces

- Plant operators were not provided with an effective means of emergency communication and were not linked into the incident communications plan.

8.11 Action taken on the recommendations of the internal investigation

The internal investigation report made 11 recommendations, as outlined in Figure 8E.

FIGURE 8E: RECOMMENDATIONS OF THE INTERNAL INVESTIGATION

1. Under no circumstances should timber ever be removed from a national park for commercial purposes.
2. Timber should only be removed from a national park as part of the development of a control line, with the written approval of the Chief Fire Officer and the Secretary of the Department of Sustainability and the Environment (in consultation with the Director of National Parks).
3. As removal of timber from the state forest for commercial purposes during the construction of a control line can potentially compromise the fire suppression effort, the practice should not be permitted without the written authorisation of the Chief Fire Officer.
4. The Fire Management Unit reinforce with incident controllers the need for effective and informed decision-making by IMTs, and managing conflict resolution be included in incident controller training programs.
5. That good governance practices be incorporated as part of training for incident controllers, with a particular focus on the need for appropriate checks and balances, clear accountability and resolution of conflict of interest issues.
6. In the event non-DSE staff are to be employed as part of the IMT, or in a supervisory role at future wildfire events, the incident controller must ensure that any potential conflict of interest is identified and appropriately managed.
7. The Fire Management Unit develop a guideline for the preparation of control lines and, within that document, there should be reference to the need for simplicity in prescriptions. The guideline should include a "suite" of standard design features, which could be used to develop a particular prescription.
8. The Fire Management Unit ensure that, as far as possible, natural and cultural values affected by a particular fire strategy are recognised and documented, by including local staff with knowledge of the terrain and land tenure issues as part of the IMT.
9. The resources required, including supervisory resources, to achieve any fire pre-suppression or suppression task, particularly where non-standard techniques or practices are proposed, should always be considered when developing containment strategies. This should be reinforced in all future training programs.
10. The Fire Management Unit review its approach to resourcing of IMTs to ensure, as far as practicable, some degree of continuity is maintained to strengthen the decision-making process.
11. The Fire Management Unit remind incident controllers of their legislative obligations and reinforce the need to ensure legislative requirements are adhered to in the development of fire strategies.

Source: Report on the Internal Investigation into the Yalmy control line, DSE.

The recommendations of the internal investigation are being addressed by DSE as follows:

- in relation to recommendations 1, 2 and 3, DSE has provided a number of presentations to staff, emphasising that appropriate approvals are required for the removal of timber from national parks and that commercial use of such timber is illegal
- recommendations 4, 5 and 6 have been included in staff training programs and the relevant information is also intended to be provided to incident controllers during their annual staff debriefs and updates
- the matters described in recommendation 7 are intended by DSE to be incorporated in the Fire Management Unit's cyclical review of its operations manual
- actions supporting recommendations 8, 9 and 11 are in place under current management practices
- recommendation 10 was actioned in 2003 as part of the implementation of recommendations arising out of the 2003 Victorian Bushfire Inquiry⁷.

Conclusion

We are satisfied that DSE has taken appropriate action to address the recommendations made by the internal investigation.

⁷ Department of Premier and Cabinet 2003, *Report on the Inquiry into the 2002-2003 Victorian Bushfires*, report prepared by B Esplin, M Gill, N Enright, Melbourne. The inquiry was established to look into all aspects of the preparations for, and response to, the 2002-03 Victorian bushfires, and to identify opportunities to learn from them and further improve Victoria's fire management capability, prevention, mitigation and response.



9. Administration of the contractor assistance program



9.1 Audit conclusion

In 2002, the government announced its aim to reduce the volume of hardwood sawlogs harvested in Victoria's state forests through the buy-back of licences. The contractor assistance program (CAP) was established to assist contractors affected by the buy-back program and exiting the industry. The Department of Sustainability and Environment (DSE) had overall responsibility for the assistance program.

In 2004, a number of correspondents raised issues with my office concerning the management of CAP. The issues centred on the prioritisation process employed to provide CAP assistance. Given these concerns, I decided to conduct an audit of the program.

The program attracted 175 applicants, many more than originally anticipated. To assist all eligible applicants would have required funding in excess of initial and revised funding estimates.

To address this situation, assistance was provided to 38 eligible applicants assessed as a high priority in a first round of the program. This exhausted funding available for the program at that time. A further 119 applications were put on hold until additional funding became available. The initial guidelines did not mention the prioritisation process and therefore contributed to the expectation that all eligible applicants would receive assistance.

While additional funding was subsequently made available, it was insufficient to assist all remaining applicants. Program guidelines and priority criteria were amended that effectively limited eligibility for assistance to applicants from specific areas. Following assessment on this revised basis, 25 of the remaining applicants received assistance. The remainder still interested in receiving assistance were deemed ineligible or advised that their applications would not be considered further.

Our review identified that many of the management processes used in the program were effective. However, we also identified a number of issues to be considered when developing and implementing future assistance programs. These included ensuring:

- detailed funding estimates are developed in the initial stages of the program
- potential applicants are fully informed of all aspects of the program, particularly where not all eligible applicants will receive assistance, applications are to be prioritised or provision exists for amending criteria during the assessment process

- decisions on assistance to individual applicants are fully supported by documentation
- realistic deadlines are set for the receipt of applications and supporting information, and policies for late applications are clearly developed and complied with
- processing of applications for assistance and notification of applicants of the outcome of assessment processes is timely.

RESPONSE provided by the Chief Executive Officer, Rural Finance Corporation

The conclusion states that “The initial guidelines did not mention the prioritisation process and therefore contributed to the expectation that all eligible applicants would receive assistance.”

This statement does not disclose the full position as evidence that a priority process was in place as referred to in Section 9.7.1 of the report viz:

“Reference to applications being prioritised was provided in:

- *the expressions of interest advertised on the RFC website*
- *advertisements in Melbourne and regional newspapers*
- *public information sessions*
- *a covering letter provided to all contractors with the guidelines.”*

The statement in the audit conclusion in our view needs to be made in full context to give an accurate account of the situation.

RESPONSE provided by the Secretary, Department for Victorian Communities

I have noted the comments in the report on the processing of applications for non-business elements of the Contractor Assistance Package.

9.2 Overview of the contractor assistance program

Licences are issued to allow the harvesting of wood in designated areas of Victoria’s state forests. In early 2002, after recognising that those areas of state forest available for commercial harvesting were being logged at unsustainable rates, the government introduced its \$80 million, *Our Forests, Our Future* (OFOF) policy statement. The Department of Sustainability and Environment (DSE) has overall responsibility for implementation of OFOF.

The first step in the reform process was to reduce the volume of hardwood sawlogs taken under State licence by 31 per cent, to around 568 000 cubic metres a year. This reduction was to be achieved by a state government offer to buy-back sawlog licences, in whole or in part.

A contractor assistance program and a worker assistance program (WAP) supported the buy-back program, known as the Voluntary Licence Reduction Program (VLRP). The CAP was primarily designed to assist harvest and haulage contractors and other business owners, whose businesses were affected by the licence buy-back. The program also aimed to help contractors to find new jobs, obtain new work skills or voluntarily retire from the industry. The WAP was designed to financially assist workers directly affected by the buy-back of sawlog licences and the exit of contractors from the industry.

The government aimed to complete the OFOF program by the end of 2006. DSE planned for the sawlog licence buy-back, the WAP and CAP to take place within this period.

The CAP was announced in August 2002, and program guidelines were issued in November 2002. The program consisted of “business” and “non-business” elements. Under the business element, approved applicants were to receive compensation for 100 per cent of the projected loss on the sale of operational plant and equipment, reimbursement of statutory redundancy entitlements paid to employees, and reimbursement of up to \$1 000 towards the cost of obtaining professional advice. DSE contracted administration of this element to the Rural Finance Corporation (RFC).

The non-business element comprised a one-off, up-front industry restructure payment, training and other assistance to help contractor principals find a new job and, where necessary, relocate. DSE contracted administration of this element to the Department for Victorian Communities (DVC).

A total of 175 applications for assistance were received. Applicants included harvest and haulage contractors, secondary processors and businesses providing ancillary and support services to the timber industry.

The program consisted of 2 rounds of assistance payments, the first between December 2002 and May 2003 and the second commencing in December 2003 and largely completed by May 2004.

This office audited CAP in 2003 as part of a broader review of the Voluntary Licence Reduction Program. The report, outlining the findings of this audit, was tabled in parliament in October 2003¹. At the time that report was prepared, round one of the program had been effectively completed.

¹ Victorian Auditor-General's Office, *Managing logging in State forests*, October 2003.

The report outlined that by 30 September 2003:

- 36 applicants had received, or were assessed as eligible to receive, assistance through the business elements component of the contractor assistance program
- 2 contractors were assessed as eligible for only the non-business elements of the program
- 119 applications were on hold
- 19 applications were assessed as ineligible for the program or had withdrawn.

The report indicated that delays in implementing the CAP created uncertainty for contractors and recommended the completion of the program as a priority.

Following that report, in December 2003, DSE amended the eligibility guidelines for assistance. Assessment of the 119 applications (held over from round one) was made against these amended guidelines during the second round. Following this process, 25 applicants in the Central Gippsland and Dandenong forest management areas received assistance. The remainder were deemed to be ineligible for assistance or advised that their applications would not be considered further.

9.3 Audit purpose and scope

In 2004, a number of correspondents raised issues with this Office concerning the management of the CAP. The issues centred on the prioritisation process employed by DSE to provide CAP assistance. Most correspondents considered they were initially eligible for assistance under the November 2002 program guidelines yet ineligible when DSE imposed priority criteria in December 2003.

Concerns were also expressed that guidelines were inconsistently applied when assessing eligibility for assistance, and the time taken to finalise the assessment process.

Given these concerns, I decided to conduct an audit of the contractor assistance program. This audit examined the validity of the issues raised by assessing whether the:

- CAP program was adequately planned
- administration of the various elements of the CAP had:
 - complied with the contractor assistance guidelines
 - assessed applications in a fair manner.

As the program is now effectively complete, the audit also assessed whether the objectives of the program were achieved.

9.4 Status of the contractor assistance program

In December 2003, the Minister for the Environment approved the finalisation of the CAP. The program was effectively completed at the date of audit. Figure 9A details assistance provided through the business and non-business elements of the CAP.

FIGURE 9A: CONTRACTOR ASSISTANCE (BUSINESS AND NON-BUSINESS ELEMENTS) PROVIDED AS AT OCTOBER 2004

Outcome	CAP assistance provided - Business elements		CAP assistance provided - Non business elements		Total (\$m)
	(no.)	(\$m)	(no.)	(\$m)	
Applications received	175	-	-	-	
Applications settled:					
• round 1	(a) 38	7.5	49	3.1	10.6
• round 2 (b)	25	4.5	29	1.8	6.3
Total	63	(d) 12.0	(e) 78	(e) 4.9	16.9
Applications not proceeding:					
• declined (c)	48	n/a	n/a	n/a	-
• lapsed (c)	45	(d)	n/a	n/a	-
• withdrawn (c)	19	n/a	n/a	n/a	-
Total applications not proceeding	112	n/a	n/a	n/a	-

(a) 2 applicants were assessed as eligible for CAP but did not receive *business elements* assistance, as they did not have plant and equipment. They were eligible for non-business element assistance and their employees were eligible for assistance under the Worker Assistance Program (WAP).

(b) One contractor delayed his exit to complete an existing contract. This process was finalised by mid November 2004.

(c) Declined: applicants were ineligible or did not meet priority criteria; Lapsed: applicants did not supply required information within the required timeframe; Withdrawn: application for assistance was withdrawn due to the contractor having ongoing work or not serious about exiting the industry.

(d) Payments totalling \$24 367 were made to 32 unsuccessful applicants for the reimbursement of professional fees incurred in preparing their CAP applications.

(e) Figures exclude 10 applications not yet fully processed by DVC. Estimates for the Industry Restructure Package component of these applications are around \$700 000.

Source: Information provided by Rural Finance Corporation and Department for Victorian Communities.

9.5 Planning and management of the contractor assistance program

As with all government programs, sound planning and management was important to achieving the CAP objectives. To assess, this we examined whether:

- the program was structured to achieve objectives
- appropriate budgets and timelines were established
- roles and responsibilities of all parties were clearly stated and appropriate governance arrangements were in place
- detailed program and communication plans were established.

9.5.1 Program budget and timelines

In 2002-03, the government provided \$80 million for implementing the OFOF policy, which was allocated as follows:

- industry transition (\$47 million)
- worker assistance program (\$15 million)
- other forest projects (\$18 million).

There was no separate budget allocation for the CAP.

Based on estimates of the annual reduction required in wood harvested and the experience obtained from a previous restructuring package (the Forest Industry Structural Adjustment Package), DSE provided a preliminary estimate of the cost of compensating contractors under CAP at \$3 million. This amount was to be provided out of the \$47 million allocated for industry transition assistance. DSE intended to confirm the preliminary cost estimate following negotiations with industry stakeholders and finalising details of the program.

From the date of its creation in early 2002, the Industry Transition Taskforce (ITT)² expressed concern to DSE and to the then Minister for Environment and Conservation, on the adequacy of funding for the program.

On 23 July 2002, the ITT informed the then Minister that it estimated the cost of contractor business exits, including assistance for principals, redundancy payments for employees and compensation for the projected loss on plant and equipment, would be around \$15 million.

² The Industry Transition Taskforce was established to provide the Minister for the Environment with strategic advice on the implementation of the OFOF initiatives.

This estimate did not take account of additional costs that could result from:

- buy-back of sawlog licences in areas where resource reductions were not initially planned, for example, Benalla/Mansfield and Tambo
- buy-back of licences in excess of what was originally planned.

In June 2002, DSE engaged consultants to cost the proposals put to the government by the ITT. In 2 reports, the consultants estimated costs based on a number of scenarios as more applications were received than originally anticipated. These estimates are shown in Figure 9B.

FIGURE 9B: COST ESTIMATES FOR CAP PROGRAM

Date of estimate	Scenarios	Estimated cost of assistance
		(\$million)
1. 19 December 2002	50 exits to match licence reduction	16.6
2. 19 December 2002	80 exits based on high level of applications received	26.0
3. 14 February 2003	62 exits to remove excess industry capacity	17.4
4. 14 February 2003	74 exits due to income of businesses impacted by more than 50 per cent.	20.8

Source: Information from consultant's reports.

Based on the consultant's most conservative estimate of \$16.6 million, the preliminary estimate of \$3 million was inadequate.

In March 2003, DSE requested additional funding for the OFOF program and acknowledged that the funding previously available for contractor assistance was insufficient. It provided 2 funding options:

- a full cost option of \$23.1 million, providing for 74 business exits at a cost of \$20.8 million
- a reduced cost option of \$14.9 million providing for 35 business exits at a cost of \$12.6 million.

The government approved the reduced cost option.

The cost of the assistance provided to the 36 successful applicants in round one of the program roughly equated with the \$12.6 million available to fund the program at that time.

In late 2003, DSE allocated a further \$6.8 million, from identified savings in the OFOF budget and from redirecting surplus funds available in a previous program, the Forest Industry Structural Adjustment Program, to fund contractor exits in round 2 of the program.

Recommendation

1. **That when establishing future assistance programs, DSE ensure that detailed cost estimates are determined during the initial planning and that the availability of funding is used as a key determinant in the development of program criteria.**

RESPONSE provided by the Secretary, Department of Sustainability and Environment

Recommendation agreed. To the extent that this is possible, given the quality of the data available to determine cost estimates.

9.5.2 Roles, responsibilities and governance arrangements

A number of government and industry bodies with industry expertise and skills were involved in the management and administration of the CAP, as outlined in Figure 9C.

FIGURE 9C: KEY PARTIES INVOLVED AND THEIR ROLES AND RESPONSIBILITIES IN THE CAP

Key parties	Role / Responsibilities
Department of Sustainability and Environment	Overall policy responsibility for implementation and reporting on OFOF policy and programs. Assisted the processing of round 2 CAP applications.
Interdepartmental Committee (IDC) Department Secretaries or Deputy Secretaries from the Departments of Sustainability and Environment, Premier and Cabinet, Treasury and Finance and Victorian Communities	Provide high-level policy and implementation oversight of OFOF decisions and projects.
Industry Transition Taskforce Experts in the forest industry and representatives from the Departments of Sustainability and Environment, Innovation, Industry and Regional Development and Treasury and Finance	Provide the responsible minister with strategic advice on the monitoring and implementation of OFOF initiatives. ITT ceased to operate from 28 October 2003.
Industry Consultative Forum Representatives from Construction, Forestry, Mining and Energy Union, Victorian Association of Forest Industries, Victorian Forest Harvesting and Cartage Council and Chairman ITT	Specialist input into the activities of ITT and in development and implementation of OFOF programs.
Rural Finance Corporation (RFC) Administration and legal staff primarily involved in CAP business elements program administration	CAP administrator. Determines eligibility of contractor after consulting with ITT regarding priorities and processes business element assistance payments.
Department for Victorian Communities (DVC) Department has established a Forestry Worker and Contractor Assistance Program Unit to administer non-business elements of CAP payments	Assesses and administers non-business element payments to eligible contractor principals including initial one-off industry restructure payment, training, job search, relocation and reemployment assistance.

Source: Information provided by DSE and contractor assistance guidelines, November 2002.

We concluded that many aspects of the management structure were effective. In particular:

- the roles and responsibilities of the parties involved in the program were clearly outlined in the CAP guidelines and other terms of reference documents
- the membership of the IDC was appropriate and the committee had access to the specialist advice needed to assist in decision making
- decisions made by the oversight body were adequately supported and documented
- appropriate reporting mechanisms were established, with the IDC and minister receiving regular and comprehensive reports on the progress of the program
- Key staff involved in the program were specifically chosen based on their specialist skills and experience and largely worked on the program from the start to finish.

We identified a number of areas where management of the program could be improved:

- The main purpose of the ITT was to provide advice to the minister on implementation of the OFOF. However, under CAP guidelines, the ITT's role was broadened to include consulting with the RFC on prioritising applications for processing. The expansion of ITT's role created a potential conflict of interest for industry representatives on the taskforce. We saw no evidence that this potential conflict was considered and managed.
- While a probity auditor was engaged by RFC (as required by DSE) to undertake an initial review of the proposed evaluation process for the VLRP (sawlog licence buy-back program), no mechanism was established for independent review of the ongoing management and administration of the CAP.
- A post-implementation review of the CAP has not been planned. Such a review would enable an assessment of the outcome of the program and allow identification of potential improvements for the management of similar programs in the future.

Recommendations

2. **That for future programs of this type:**
 - **potential for conflict of interest of industry specialists be clearly identified and effectively managed**
 - **a probity auditor be engaged to independently review key aspects of the programs, including the development of program guidelines, the assessment of applications and the ongoing implementation of the programs.**
3. **That DSE undertake a post-implementation review of the CAP.**

RESPONSE provided by the Secretary, Department of Sustainability and Environment

Recommendation 2 agreed.

Agree in principle that post implementation reviews should be conducted for major initiatives. However in this particular case, the two audits conducted by the Victorian Auditor General's Office and DSE's own internal audit of CAP have extensively reviewed program design and implementation and provided sufficient material to constitute a post implementation review.

RESPONSE provided by the Chief Executive Officer, Rural Finance Corporation

Similar processes for administering VLRP and CAP applications were implemented by RFC. Having obtained a probity audit of VLRP process, a further probity audit of the CAP was not considered necessary.

9.5.3 Detailed plan

DSE developed a detailed plan for the implementation of the program that:

- outlined the activities to be undertaken
- assigned responsibility for tasks
- established timelines for completion of activities.

The plan did not include cost budgets for each of the program's key activities. Some budget information was provided in agreements between DSE and RFC and DVC. However, other budget information in relation to activities undertaken by DSE and ITT was not well-documented and cost budgets for various activities changed considerably during program implementation.

Recommendation

4. **That, in future, cost budgets be developed for all key components of a program and included in the program plan.**

RESPONSE provided by the Secretary, Department of Sustainability and Environment

Recommendation partially agreed. DSE does not accept that costs budgets were not developed for key components of the program but accepts the need for more effectively integrating costing information into program design decision in future programs.

9.6 Adequacy of the assessment process

9.6.1 Assessment processes used

Initial CAP guidelines indicated contractor businesses that were proposing to totally or partially exit from the industry may be eligible for assistance if they could demonstrate that they:

- directly participated in the native forest timber industry or
- derived at least 50 per cent of their total gross income from working in the industry, and
- were adversely (financially) affected by the reduction in sawmill licences.

To provide guidance to the ITT in determining priorities, the IDC determined that the number of contractor exits required should be based on the reduced annual harvest of timber in each forest management area (FMA) (resulting from the sawlog licence buy-back). The buy-back of sawlog licences was completed in July 2003.

Before any assessments of eligibility, ITT prioritised all applications. As a result, ITT was effectively responsible for the initial determination of the overall number of exits required. DSE assumed this role for the second round of the assessment process.

ITT's prioritisation methodology, where applicants were assigned an A, B, or C priority rating, was based on whether:

- the applicant was:
 - a bona fide harvest or haulage contractor
 - from the Midlands, North East or East Gippsland FMAs
 - serious about exiting the industry
- the number of applications for assistance in each of the above-mentioned FMAs, matched the number of contractors required to exit from that FMA.

Applicants satisfying all 4 criteria were classified as an A priority, indicating that they were in the group with the highest need for funding.

Applications, which met the first 3 of the criteria but not the fourth, were to be assessed against separate eligibility criteria, designed to assist the least efficient contractors to exit the industry. Applicants satisfying these secondary criteria were then to be included with the other A priority applications, the remainder were classified as B priority. Applicants not meeting one or more of the first 3 criteria were classified as a B or C priority.

No specific mention of this prioritisation process was made in the guidelines issued to potential applicants. However, DSE advised that the prioritisation process was made known to applicants in other correspondence and during various presentations.

Of the 175 applications received, 41 were classified by the ITT as an A priority. They were referred to the RFC for assessment against the eligibility criteria outlined in the guidelines and for determination of assistance under the business element of the program. At the same time, applicant details were provided to the Department for Victorian Communities to enable assessment of eligibility for the non-business component of the program and to calculate the assistance to be provided.

Thirty-eight of the 41 priority A applicants received financial assistance to exit the industry. The remaining 3 applications were withdrawn, lapsed or declined. Assessment of the remaining applications was put on hold to enable DSE to consider:

- the additional demand for logging contractors to assist with the harvesting of fire damaged trees, following bushfires at the start of 2003
- reduction in annual sawlogs harvested, resulting from the VLRP licence buy-back process.

Key aspects of the CAP process are outlined in Figure 9D.

FIGURE 9D: CONTRACTOR ASSISTANCE PROGRAM – KEY ASPECTS OF THE ASSESSMENT PROCESS

Key aspects	Details
Expression of interest to be lodged by applicants	Closing date 29 November 2002.
Supporting evidence to be provided within 14 days of the application being submitted. Other information may be requested to allow a proper assessment of a contractor's position	Evidence to be provided: <ul style="list-style-type: none"> • business engaged in native forest timber industry at date of OFOF policy announcement, 21 February 2002 • registration of business • relevant income tax returns for 1999-2000, 2000-01, 2001-02 • cash flow projections for 2002-03 and 2003-04 and a statement of financial position as at the date of application or as close to as possible • work performed in Victorian native forest timber industry e.g. contracts • how OFOF policy has adversely affected the business e.g. termination of contracts.
CAP assistance is not an automatic entitlement of businesses electing to exit the industry. Assistance will only be approved where the contractor has demonstrated eligibility against the stated criteria	Eligibility criteria: <ul style="list-style-type: none"> • direct participation in the native forest timber industry or • direct dependence on the industry. At least 50 per cent of total gross income derived from a contract for the direct supply of goods and services to the industry directly related to harvesting, haulage and processing of hardwood timber including the transport of woodchips for stock piling and dispatch and • adverse financial consequences directly and principally incurred because of the implementation of the OFOF policy (i.e. reduction in sawmill licences).
The process for assessing applications and key parties involved	RFC: <ul style="list-style-type: none"> • determine the completeness of each application. • send applications to ITT for prioritising • for 'A' priority applications, determine eligibility and advise applicant of that determination. • for reject applications, advise applicant of reason/s for the rejection. • refer applications to valuer, reimburse professional fees, and refer applications to DVC for assessing eligibility for the non-business elements of CAP. • pay projected loss on sale of plant and equipment. DVC: On referral from RFC, determine eligibility of contractor principals for non-business assistance.
Establishment of an Independent Review Panel	To consider applicants' objections to RFC and DVC decisions.

Source: Our Forests Our Future Industry Transition Program contractor assistance program - application guidelines, issued November 2002 and information from RFC and DSE.

Exit assistance provided to priority A applicants in round one exhausted available funding for the CAP. DSE estimated that the cost of assisting all 119 applicants on hold after completion of round one would be around \$39 million.

In mid October 2003, DSE commenced the final stage of the CAP. As information originally provided by the remaining 119 applicants was almost 12 months old, RFC requested updated information from applicants if they still wished to be considered for assistance.

All applicants with the exception of 16 applicants from those Otways and Central FMAs who were not part of the OFOF, were contacted and asked to update the information provided in their application. Applicants not in the Dandenong and Central Gippsland priority FMAs were advised that it was unlikely they would receive assistance. However, they could still provide updated information for consideration. Assistance was limited to the Central Gippsland and Dandenong FMAs, as DSE considered:

- they were the remaining areas most affected by the resource reductions
- a strengthening residual log market increased the demand for haulage capacity in other areas
- there was no need for additional exits in other FMAs given the contractor exits that had already occurred.

Of the 103 applicants contacted by RFC in mid-November 2003, 65 indicated that they were still interested in exiting the industry and receiving CAP assistance. These applications comprised:

- 36 harvest and haulage contractors in the Central Gippsland and Dandenong FMAs
- 13 harvest and cartage contractors in other FMAs
- 16 secondary processors or businesses providing ancillary or support services to the industry.

Initial estimates of the likely cost (under the December 2002 guidelines) to provide assistance to the 65 applicants was around \$20 million.

The initial program guidelines stated that *“the guidelines may be subject to further review in light of developments in restructuring the native forest industry and achievement of the Government’s objectives”*. The guidelines were amended in December 2003 given limited funding to meet the cost of all applications for assistance. These amendments effectively limited:

- contractor assistance to the Central Gippsland and Dandenong FMAs
- contractor assistance to harvest and haulage contractors and specifically excluded applications from secondary processors and support businesses
- the level of assistance available to eligible applicants. Relocation assistance was reduced from \$30 000 to \$10 000 and plant and equipment assistance was limited to specialists. The amount of time in which approved assistance could be accessed by contractor principals was reduced from 24 months to 3 months.

While some applicants withdrew due to ongoing work in the industry, the change to the guidelines effectively reduced the number of applicants to 36 of which 25 were found to be eligible. The estimated cost to finalise round 2 of the program at November 2004 was \$6.3 million.

9.6.2 Outcome of assessment processes

The level of contractors (harvest and haulage contractors) estimated to be in excess of industry requirements following the licence buy-back, and the actual CAP exits are shown in Figure 9E.

FIGURE 9E: REQUIRED AND ACTUAL CONTRACTOR EXITS BY FMA

Forest Management Area (FMA)	Estimated contractors in excess of future requirements (a)	Actual CAP contractor exits
	(no.)	(no.)
East Gippsland	17	22
Midlands	6	8
North East	0	2
Portland	2	1
Tambo	1	1
Benalla/Mansfield	-	1
Central Gippsland	29	18
Dandenong	7	8
Central	(7)	-
Otway (b)	5	-
Mid Murray	-	-
Bendigo	-	-
Horsham	-	-
Mildura	-	-
Total	60	(c) 61

Legend:  Round 1 Priority FMAs  Round 2 Priority FMAs

- (a) Estimate of required contractor exits submitted to the Inter Departmental Committee, 30 January 2003.
- (b) Resource reductions in Otway were the subject of a separate government policy initiative and not part of the OFOF policy. As a result, no contractors were exited from Otways as a part of the CAP.
- (c) An additional 2 applicants were assessed as eligible for CAP but did not receive business elements assistance as they did not have plant and equipment. They received assistance for their employees under the Worker Assistance Program.

Source: Information provided by DSE and Victorian Auditor-General's Office, *Managing logging in State forests*, October 2003.

DSE largely achieved its target to reduce the total volume of hardwood sawlogs taken under state licence. Under the contractor assistance program, 61 contractors were assisted to exit the industry compared to a preliminary estimate of 60. While the majority of successful applicants were selected from the areas identified for priority, we identified that:

- the number of contractors exited in each FMA did not necessarily equate with the preliminary estimate of contractors to be in excess of requirements
- applications from the Portland, Tambo and Benalla/Mansfield FMAs were exited despite these not being identified as priority areas
- 2 of the applications prioritised in round one were from ancillary businesses despite a priority to exit harvest and haulage contractors.

DSE advised that estimates of the number of contractors required to exit each forest management area were intended only as a general guide.

Information obtained during the audit indicated that generally contractors who received assistance under the program were satisfied with the amount of assistance received.

Not all applicants impacted by the reductions in logging activity received assistance. This is particularly true of businesses providing support and ancillary services to the industry.

The government's objective was to complete its OFOF program by the end of 2006, 4 years after it commenced. DSE planned for the sawmill licence buy-back, the workers assistance and CAP programs to take place within this period. With the CAP largely completed in March 2004, the management of the program was timely. However, the time taken by DSE to resolve some applications was excessive with over a year expiring between the lodgement of initial applications and notification of the outcome of the application for some applicants.

9.7 Potential for improvement to assessment and management processes

Our review of the assessment and management processes used for the program identified a number of matters, as set out in the following paragraphs.

9.7.1 Adequacy of communication to potential applicants

Information about the CAP was conveyed to potential applicants through a number of means, including:

- program guidelines
- website information
- public advertisements
- published material, including a fact sheet and expression of interest document
- responses to queries regarding the program
- industry association networks
- public meetings and information sessions
- correspondence to applicants.

The following specific references to the assessment process were included in the guidelines:

- the processes were designed to ensure that applications would be dealt with in a coordinated and understood manner
- eligibility for assistance would be determined after consultation with ITT and applicants would be provided with advice of that determination
- where an application was deemed ineligible, the applicant was to be advised of the decision and provided with a written explanation.

No reference was made in the CAP guidelines (November 2002) or in the CAP fact sheet (August 2002) to a prioritisation process. Reference to applications being prioritised was provided in:

- the expressions of interest advertised on the RFC website
- advertisements in Melbourne and regional newspapers
- public information sessions
- a covering letter provided to all contractors with the guidelines.

DSE believes that potential applicants reading these documents or attending presentations should have been aware that their applications for assistance were likely to be prioritised as part of the assessment process. However, expectations amongst contractors who contacted my Office were that all would receive assistance if they could demonstrate an impact from the reductions in logging. The absence of mention of the prioritisation process in the guidelines or fact sheet contributed to these expectations.

Applicants were first told of the criteria used in the prioritisation process when they received advice on their priority rating (around mid-December 2002). However, an explanation of why an application received a particular priority rating by the ITT was not provided.

The CAP guidelines and fact sheet did not disclose sufficient information on the assessment process, in particular the basis for assigning priorities to enable applicants to understand how applications were to be assessed, funds available and how such funds would be allocated.

Recommendation

5. **That documentation provided in future assistance programs be more specific on:**
 - **the level of funding available for the program**
 - **all criteria to be used to determine eligibility and priorities for assistance**
 - **the assessment process**
 - **the basis to be used to allocate assistance funding where the total assistance likely to be paid to eligible applicants exceeds the funding available**
 - **indicative timelines for decisions such as determining eligibility for assistance and calculating assistance payments.**

RESPONSE provided by the Secretary, Department of Sustainability and Environment

Point 1 of recommendation 5 partially agreed. DSE does not accept that the level of funding available for a program should in all cases be publicly available because it can prejudice the effective management of such programs.

All other Points of the recommendation agreed. A major unforeseen event, such as the 2003 Alpine Fires which had a major impact on DSE's capacity to quickly resolve outstanding CAP applications, can occur to hinder the efficient administration of future programs.

9.7.2 Late submission of information supporting applications

Supporting information was to be provided by applicants within 14 days of the closing date for applications, 13 December 2002. In practice, applicants often submitted supporting information well after this date.

At the expiry of the 14 day period, RFC allowed a further 14 days for the receipt of supporting information (to the end of December 2002). This extension was to ensure “*maximum availability and uptake of the package*”³. However, there were many instances where supporting information continued to be provided in the period January 2003 to July 2003.

In one instance, RFC continually requested information from an applicant over a 4 month period. At one stage, the application was rejected on the basis that the information was not forthcoming. However, when the information was eventually supplied, the application was accepted and assistance provided.

In accepting late information, RFC was assisting applicants who may have been unable to meet deadlines. However, allowing applicants to provide supporting information after the advised date can create potential inequities where some applicants are allowed more time to provide information to support their applications than others.

Recommendation

- 6. That, in future, guidelines clearly stipulate agency’s time requirements for providing supporting information and that programs are administered in accordance with these timeframes.**

RESPONSE provided by the Secretary, Department of Sustainability and Environment

Recommendation agreed.

RESPONSE provided by the Chief Executive Officer, Rural Finance Corporation

The suggestion that RFC’s decision to allow applicants to provide supporting information after the advised date can create potential inequities is in our view without foundation in the administration of CAP.

RFC believes it exercised sympathetic and sound judgement and demonstrated an understanding of the impracticality of insisting on accompanying data being supplied within 14 days, when clearly accountants representing a number of contractors were physically unable to complete company and personal income tax returns by the time allowed.

Sensible discretion was exercised by RFC in granting extensions in individual circumstances thereby avoiding a potential rash of complaints from aggrieved applicants.

In our view no applicant, or potential applicant, was disadvantaged by RFC allowing reasonable opportunity to submit supporting information.

³ Memorandum to Chairman ITT from Manager ITT Secretariat, 12 December 2002.

9.7.3 Treatment of late applications

Closing dates are specified in programs, such as the CAP, to establish a structure for administration of the program, to ensure timely completion and to facilitate equitable treatment of all applications.

While program guidelines stipulated that applications were to be lodged by 29 November 2002, they did not specifically address the treatment of late applications.

Nine late applications, received from one week to 5 months after the closing date, were accepted. The reason given for late applications were that applicants were unaware of either the program or the closure of the sawmill for which they supplied logs.

Accepting late applications makes a program administratively more difficult and increases the risk of inequitable treatment of applications. For example, a contractor may not submit an application if the closing date has passed as they consider it unlikely to be accepted. In this situation, they are at a disadvantage compared with someone who has a late application accepted.

Recommendation

- 7. To minimise the likelihood of late applications, the department should ensure that realistic deadlines are created for the receipt of applications for future assistance programs. The process for handling late applications for assistance should also be clearly stated in program guidelines and complied with.**

RESPONSE provided by the Secretary, Department of Sustainability and Environment

Recommendation agreed.

However, developments during implementation of the Our Forests Our Future licence buyback scheme, particularly the policy decision by Government to buy back a greater sawlog volume than was required to achieve the resource reductions in some FMAs, can make it inequitable not to accept late applications, as the affected contractors would not have been able to properly assess their likelihood of being affected.

RESPONSE provided by the Chief Executive Officer, Rural Finance Corporation

The deadline for accepting applications (as distinct from supplementary information referred to in 9.7.2) was strictly controlled by RFC.

The only deviations from this stance were:

- from late applicants who were able to demonstrate that the application had in fact been posted in time to arrive by the due date based on normal Australia Post delivery expectations and,*
- late applications from non priority FMA's following the closure of mills in those areas on advice from DSE or ITT.*

9.7.4 Need for improved documentation of decisions

Our review of applications for assistance and ITT records disclosed very little documentation supporting the ITT's prioritisation strategy or the actual prioritisation of applications. Most application forms indicated:

- the assigned priority rating
- details of the type of business (harvest or haulage)
- whether or not the contractor was serious or not about exiting the industry (where ITT had contacted the applicant).

Information to support the ITT's prioritisation decision was not always evident on the application. Some applicants received assistance but there was no evidence indicating they were serious about exiting the industry or to support that they were harvest and haulage contractors.

In addition, there was no documented justification for why:

- some applicants were rated an A priority, when they were located outside of a priority FMA or were not a harvest or haulage contractor
- more or less contractors were exited from FMAs than identified as necessary
- a particular application was selected for assistance, when a number of applications that met the criteria for an A rating did not receive assistance.

DSE advised that there was limited need for documentation of these matters due to the small size of the industry with applicants generally well known to the members of the ITT. However, despite this knowledge, it is desirable that all decisions are fully supported by documentation.

Recommendation

- 8. That all decisions on prioritisation be clearly documented and adequately supported to ensure the integrity of assistance programs.**

RESPONSE provided by the Secretary, Department of Sustainability and Environment

Recommendation agreed.

9.7.5 Notification of outcomes to applicants

All applicants received initial notification of their priority rating around mid-December 2002. They were advised that, if their priority status changed, they would be further notified. Formal communication with applicants occurred almost one year later, in November 2003.

Although this information was in the guidelines, letters of regret sent to applicants in December 2003 following round 2 of the program did not make mention of:

- the independent review process available to applicants wishing to object to priority or eligibility decisions
- an applicant's entitlement (notwithstanding they were ineligible for other assistance) to receive up to \$1 000 to reimburse professional costs incurred in preparing their CAP applications. A reminder of this entitlement was however included in offers of assistance to eligible applicants.

Recommendation

- 9. That, in managing future assistance programs, DSE ensure communication with applicants is timely, particularly where administration and assessment processes continue over an extended period.**

RESPONSE provided by the Secretary, Department of Sustainability and Environment

Recommendation agreed.

RESPONSE provided by the Chief Executive Officer, Rural Finance Corporation

All applicants received initial notification of their priority rating around mid December 2002 and were told that they would be communicated with again when there was a change in their priority status.

In cases where the status did not change and the applicants initiated a request for an update on their status the applicants were responded to accordingly.

This position needs to be made clearer in the report which currently gives the impression that applicants had not been contacted for up to 12 months.

On the issue of notification of an appeals process RFC took the view the guidelines clearly explained this process and did not require repeating.

9.7.6 Appeals process

Program guidelines specified that RFC was to determine the eligibility or ineligibility of each application. For applications deemed ineligible, applicants were to be informed of the reason for their ineligibility. Provision was also made in guidelines for unsuccessful applicants to appeal the eligibility decision.

The program provided a 2-part process to review assessments, where applicants were unhappy with eligibility decisions. This process consisted of:

- An internal review of assessment decisions following a written request from the applicant. These reviews were conducted by RFC, who were required to advise the applicant within 5 days of the review outcome.
- examination by an independent panel where applicants appealed against the outcome of the RFC review.

To successfully appeal, the guidelines required applicants to demonstrate how they satisfied selection criteria and provide grounds on which their appeal against the eligibility decision was made. The guidelines did not provide for applicants to appeal the priority rating assigned to their application.

The 119 applicants on hold after the first round of the assessment process could not use the appeal process as no decision had been made as to their eligibility.

Following the revision of the guidelines in December 2003, the right to appeal was effectively removed as applicants not in priority areas were no longer eligible for assistance.

Deficiencies in the appeals process were highlighted in a legal opinion obtained by DSE.

“It seems to me that where an application is deemed not eligible, the reasons for that decision were to be set out. Looking at paras [of the guidelines], it seems to me that the required written response was intended to give some indication to the applicant as to why the application has been deemed not eligible to enable the applicant to determine whether or not an internal review should be requested or an objection lodged. Simply stating the criteria on which the decision has been made does not seem to me to be sufficient to comply with the guidelines.”

Recommendation

- 10. That the reasons for decisions on priorities in future programs are clearly communicated to enable applicants to utilise available appeal processes.**

RESPONSE provided by the Secretary, Department of Sustainability and Environment

Recommendation agreed.

9.7.7 Contractor applications on hold

After completing its prioritisation and assessment process in round one of the CAP process, DSE was left with 119 applications, which were not assessed. The department considered that most of the remaining contractors would be needed over the next 2 years to salvage timber burnt in the 2003 bushfires.

The 119 applicants assigned a B or C priority, received a letter indicating that their application would not be assessed against the criteria in the guidelines at that time and advised that they would be contacted when there was a change to their priority status.

DSE stopped processing CAP applications in May 2003 until the resources required for the salvage operations and funding required to finalise the CAP, were determined. At this time, the 119 applications had been on hold for 6 months.

With no progress made on these applications, an increasing number of complaints from applicants were received by DSE, outlining the economic hardship they were suffering due to the sawmill closures. Applicants were also critical of the CAP process especially given their expectations of support following announcements when OFOF was introduced.

Early in June 2003, RFC recommended to DSE that a public announcement be made *“to address ongoing frustration applicants are experiencing ...”* and to inform applicants that there might be no further assistance provided⁴. This announcement was not made.

The change in guidelines in December 2003 had a range of impacts on the applicants on hold and considered in round 2, in that:

- A more rigorous process of checking the eligibility of applicants was employed in round 2 than in round one. This was due to the amended guidelines requiring more stringent testing of the information, supporting each application, against the eligibility criteria. Testing involved more detailed analysis of the information provided by applicants relating to the level of income they derived from working in the industry and their attempts to find alternate work.
- The level of assistance (for business elements) provided to applicants in round 2 was, on average, 13 per cent less than that provided to applicants in the first round. This was due mainly to the December 2003 guideline changes. Several contractors were also unable to receive full compensation for their operational plant and equipment, as they had sold off items since submitting their CAP application in November 2002. In these cases, the sales were undertaken in order to meet pressing financial commitments.

Restricting eligibility for CAP to ensure there was sufficient funding was allowed for in the November 2002 guidelines. However, as reported previously, applicants did not have information on key aspects of the priority assessment process. For example, the criteria to be used in the assessment process, how the department was to prioritise applications for assistance, funding available for the program and the basis for allocation should funding be limited.

The allocation of assistance under revised guidelines raised questions concerning the equity of the program as:

- although many of the 119 applications on hold after round one may have satisfied the eligibility criteria outlined in the initial CAP guidelines, only 25 received assistance
- eligible contractors in round 2 received less assistance than those assisted in round one
- eligible contractors in round 2 had to wait around 12 months longer for assistance than eligible contractors in round one.

⁴ Letter to Professor Lyndsay Neilson, Secretary, Department of Sustainability and Environment from RFC, 3 June 2003.

Recommendation

- 11. That, where a need exists to change an established program's guidelines or eligibility criteria, these changes be clearly communicated to affected applicants. Consideration could also be given to closing the program and establishing a new one with revised requirements, rather than amending the guidelines.**

RESPONSE provided by the Secretary, Department of Sustainability and Environment

Recommendation agreed.

9.7.8 Processing of applications for non-business elements assistance

DVC, on referral from RFC, determined the eligibility of contractor principals to receive assistance in respect of the non-business elements of the CAP. At the date of audit, a total of \$4.9 million has been provided to contractor principals who exited the industry. Figure 9F outlines the key aspects of this assistance.

FIGURE 9F: KEY ASPECTS OF CAP NON-BUSINESS ASSISTANCE

Key elements	Details
Eligibility criteria	Eligibility to receive a CAP contractor exit package (from RFC). Continuous work in the Victorian native forest timber industry for at least 19 hours per week in 9 out of the 18 months prior to receiving CAP assistance.
Assistance elements	<p>Industry restructure payment (to a maximum \$80 000)</p> <ul style="list-style-type: none"> • 3 weeks pay for each year of continuous service in the industry • over 45 years old, additional 3 weeks pay for each year of service over 45 years of age • Deemed rates of pay: <ul style="list-style-type: none"> • Harvesters: \$57 000 per annum / \$1 096 per week • Haulers: \$55 000 per annum / \$1 057 per week • Other principals (secretaries, office managers, etc): \$31 200 per annum / \$600 per week. <p>Training and job search assistance (pre- and post- business closure; skills assessment; vocational training).</p> <p>Relocation assistance, up to \$30 000.</p> <p>Employment incentive scheme for employers who propose to employ a contractor principal, wage subsidy up to \$5 000.</p>

Source: CAP guidelines issued November 2002.

Contractors' applications were to be supported by appropriate documentation including group certificates, taxation returns and statutory declarations.

We examined the files of 22 contractor principals (11 in each round). We found no evidence of incorrect payments to applicants. However, the following matters were noted in relation to the processing of applications:

- DVC processed applications without appropriate documentation to substantiate length of employment in the industry for 7 of 11 round one applicants. There was a significant improvement in DVC quality assurance processes for round 2. All payments reviewed were adequately supported.
- The objectivity and independence of applicants' supporting information i.e. employment history, was limited by the fact that it was often certified by family members involved in the business.
- In round 1 the taxation implications for contractors were not properly assessed by DVC. This resulted in taxation not being deducted from assistance payments as required. This situation was rectified in round 2 with appropriate tax deducted from assistance payments.

By 15 September 2004, over 75 per cent (64 principals) of eligible contractor principals had secured another job and 13 per cent (11 principals) had retired voluntarily.

DVC has, in the main, complied with the CAP guidelines in assessing and processing contractor principal applications for assistance. In particular, the department took appropriate action to rectify taxation and quality assurance deficiencies identified in the processing of round one applications.



10. Capital budgeting and management by local governments



10.1 Audit conclusions

The 9 local governments (councils) we examined are currently not managing their capital expenditure programs as well as they could.

All but one have yet to implement a comprehensive asset management framework, covering all classes of major assets, that allow them to plan their capital expenditure “top down”, both strategically and operationally. The Municipal Association of Victoria’s (MAV) STEP program¹ is helping local governments implement such a framework, but there is still some way to go.

The local governments examined also failed to achieve their budgeted annual capital programs over the past 2 years. This experience reflects the broader experience of the sector. There are several issues within their control that they need to address, to better manage their capital expenditures, including:

- changing the timing of their capital budget processes to allow for more effort up-front in establishing expected costs
- improving capital program reporting to make their monitoring and review processes more effective.

10.2 Background

In each of 2002-03 and 2003-04, Victoria’s 79 local governments collectively spent over \$800 million acquiring and renewing assets. On average, this capital expenditure equated to 20 per cent of their total annual revenues.

Local governments make capital expenditures to:

- renew or replace existing assets that have reached the end of their service life, in order to maintain existing service levels
- add to their stock of assets, to provide new or better services.

¹ The MAV STEP program commenced in 2003 and is designed to assist councils to improve their asset management processes with support from a consortium of asset management consultants. All councils are encouraged to participate in the program.

In discharging their legislative responsibilities², local governments are required to invest significantly in infrastructure assets such as roads, bridges, drains and footpaths. Other services that local governments choose to provide (such as home and community care, recreation facilities and childcare) also require the use of assets, including land and specific-purpose buildings.

The most recent financial statements of local governments indicate that it would cost over \$37 billion to replace their existing infrastructure assets, in their present condition, with similar assets. This estimate has grown by almost \$14 billion over the past 6 years (from \$23.3 billion in 1998). It would cost considerably more to replace all existing assets with new assets.

Compared with other assets such as plant and equipment, infrastructure assets present a number of unique management challenges. While their form and function varies, their common characteristics are that they:

- are long-lived: management decisions taken today can impact on a local government for decades
- are complex: most infrastructure assets have a number of components and sub-components with different lives, and some need to integrate with other assets to function effectively (such as roads and drains)
- are costly to acquire, operate and maintain: the total “life cycle cost” of an infrastructure asset can be many times its initial acquisition cost
- generally have no market value: their value is in their use, and at the end of their lives they have little or no residual value.

10.2.1 Audit objective and scope

This audit examined how well 9 local governments conducted their capital budgeting processes. It also examined how well they monitored achievement against their expenditure plans.

While the audit looked specifically at the preparation and monitoring of annual capital budgets, it also assessed the adequacy of the broader asset management frameworks established by local governments, comprising asset management policies, strategies and plans.

The 9 local governments examined were: Ballarat, Boroondara, Brimbank, Frankston, Greater Shepparton, Warrnambool and Yarra City Councils and Moira and South Gippsland Shire Councils.

² Most local government responsibilities for infrastructure assets are specified in the *Local Government Act 1989* and *Road Management Act 2004*.

10.3 How well did local governments plan their capital expenditure?

Capital expenditure cannot be planned in a vacuum. As with the other resources that local governments use and consume to deliver services (such as personnel, information and money), physical assets need to be managed both strategically and operationally.

Ideally, asset planning should be a “top-down” process, starting with:

- asset policies and strategies, on which are based
- long-term asset management plans that cover the life cycle of the assets, on which are based
- medium-term operational plans that match corporate planning horizons, on which are based
- short-term operational plans, that match annual plans.

The medium and short-term asset operational plans should comprise acquisition, disposal, operating and maintenance plans for each class of assets.

Asset management strategies and plans should link to long, medium and short-term financial plans, including capital budgets. Ideally, each local government will establish a long-term capital plan that spans the entire life cycle of each class of asset. This will be translated into a medium-term (5 to 10 year) plan which sets out asset development or renewal plans, supported by an assessment of projected funding requirements to deliver the plan. The annual capital budget is simply extracted from the first year of the medium-term plan.

In assessing how well local governments planned their capital program, we examined:

- whether local governments had established an asset management framework
- the linkages between capital budgets and asset management plans
- processes for formulating capital budgets for individual asset renewal and acquisition projects.

10.3.1 Asset management frameworks

At the time of the audit, with the notable exception of Boroondara, none of the other local governments examined had fully established an asset management framework that included all the major classes of assets. However, all local governments were progressively implementing the key elements of such a framework.

All but 2 of the local governments examined were using the MAV's STEP program, which was helping them develop asset management frameworks. The STEP program initiative is voluntary and has been in place for the past 2 years. It should make a significant contribution to improving asset management practices.

Most local governments had established asset management policies and were developing asset management strategies. Boroondara had asset management strategies for all its major classes of assets.

Few local governments had detailed asset management plans, and most plans were only for road assets. Our discussions with local government staff indicated that the impetus for these plans was usually external, including recent amendments to the *Road Management Act 2004*³.

10.3.2 Capital budget links to asset management plans

Our audit found that while most local governments had medium-term capital budgets (generally 4 to 5 years, in line with their corporate plans), these budgets were seldom based on detailed analyses of actual capital requirements over the period of the budget. In some cases, there was a list of specific projects only for the first year of the budget.

The exception again was Boroondara, which has developed 30-year capital works projections for its infrastructure assets.

Local governments that do not have comprehensive asset management plans are restricted in their ability to determine their actual capital expenditure needs. Most local governments that do not have asset management plans use their annual depreciation expense as a proxy indicator for how much they should be spending.

Without the policies, strategies and plans that make up an asset management framework, we found that most local governments develop and evaluate capital bids as part of the annual budget preparation process. This "bottom-up" approach does not determine how much should be spent on assets. It is predicated on rationing what is available to be spent after operating expenditure needs are met from expected revenues.

³ Among other matters, the Act requires local governments to establish road registers and also facilitates the development of road management plans as part of the management systems to be implemented by local governments in performance of their road management functions.

Under this paradigm, there is an increased risk that capital expenditure is treated as a secondary issue and is perceived as discretionary. The annual capital bids essentially form a “wish list” of projects that are screened, ranked and prioritised using predetermined criteria. This list is then culled to a final list of projects that can be afforded from the current year’s available funds.

While our audit found that many local governments had sophisticated criteria for evaluating bids, a number of risks arise from this approach. They are:

- projects are approved because there is funding specifically for them (such as from grants), even if they do not satisfy the criteria
- what is available to be spent in any one year may be significantly less than what needs to be spent, leading to degradation of the local government’s stock of physical assets.

It is this last issue that is currently a significant cause for concern. By their own measures, the local governments audited have, to date, not invested sufficient funds to maintain current service levels with existing assets.

Local governments use a proxy measure of the level of expenditure required on renewing or replacing existing assets, referred to as the “renewal gap”. This measure relates annual capital expenditure to depreciation expense. Depreciation can be viewed as one measure of the “using up” of an asset’s service potential.

Figure 10A shows the gap between investment in, and consumption of, assets by the local governments examined in this audit. Ideally, over the long-term the ratio will equal 100 per cent, indicating that local governments have fully replaced or renewed their existing assets⁴. The lower the ratio, the less that local governments are presently investing in renewing or replacing existing assets. This increases the risk that these assets will not be able to be replaced when needed or that service levels will fall.

⁴ It can be argued that the ratio should be higher than 100 per cent as the replacement cost of an asset will be higher than the asset values used throughout its life to determine the annual rate of consumption.

FIGURE 10A: RENEWAL AND MAINTENANCE GAP RATIOS (PER CENT)

Local government	Renewal gap ratio (a)			Renewal and maintenance gap ratio (b)		
	2001-02	2002-03	2003-04	2001-02	2002-03	2003-04
Boroondara	115	84	76	98	87	85
Brimbank	44	54	52	71	78	75
Frankston	64	86	63	95	134	101
Greater Shepparton	111	108	95	106	105	97
Warrnambool	77	44	66	82	58	76
South Gippsland	41	31	62	63	54	80
Yarra	139	80	104	102	84	81
Ballarat	33	29	97	85	90	98
Moira	38	68	42	61	31	62
Average	65	65	73	85	80	84

(a) The renewal gap ratio measures the rate of capital spending on the renewal/replacement of infrastructure assets compared with the “value” of the assets used (depreciation) during the year.

(b) The renewal and maintenance gap ratio measures the rate of capital and maintenance spending on the renewal of infrastructure assets compared with the value of the infrastructure assets used and the planned level of maintenance during the year.

Source: Local government annual reports.

10.3.3 Project budgeting processes

At the individual project level, it is common practice to base capital expenditure budgets on business cases for each proposed asset. This is particularly important for new asset investment decisions that extend or enhance services.

The degree of analysis in a business case reflects the complexity and risks of the project, and the business case demonstrates how the preferred option best meets the service needs of the community.

A comprehensive business case for a new asset would include:

- a statement of the scope of the project and the expected outcomes (including the anticipated benefits to the community)
- a statement on how the proposed capital expenditure links to the overall asset strategy and the asset management plan for the relevant class of assets
- an analysis of the asset acquisition alternatives (for example, demand management to eliminate the need for a new asset, modifying an existing asset)
- an analysis of the asset acquisition methods (build, buy or lease)
- the funding sources for the asset (such as rates, government grants and private contributions)

- an analysis of life cycle costs (that is, all costs of construction, operation and maintenance over the life of the asset), to ensure that the asset will be financially sustainable for its whole lifetime
- expected timelines and milestones, including commencement and completion dates for the critical stages of the project
- justification for the project, based on suitable evaluation criteria
- a comprehensive risk analysis
- an external environmental, social and cultural impact analysis.

All the local governments audited prepared business cases for proposed major new asset projects, using an established business case methodology. However, we found deficiencies in a number areas, including cases of:

- no criteria having being used to prioritise projects
- no evaluation having been conducted to determine the financial and technical viability of projects
- no cost-benefit analysis having been undertaken
- no consideration of alternatives
- life cycle costs either not having been calculated, or being incomplete (for example, demolition and maintenance costs having been excluded).

Conclusions

Because they do not currently have comprehensive asset management frameworks, many local governments do not establish clear links between their long-term asset planning and their other strategic planning processes.

Our analysis indicates that most local governments audited do not yet know how much they need to spend in the long-term on each of their major classes of assets. They do not yet have complete and reliable time lines that profile required capital expenditure for existing assets. Nor do they have detailed information about the new assets they may need in future to meet changing demands, or about which existing assets may become obsolete because of changing needs.

Local governments generally plan to spend what is available, rather than what is needed. While some might consider this as fiscally responsible in the short-term, it creates real issues of inter-generational equity. It is a question of whether current users of services should pay for the assets they “consume” through rates and user charges, or whether future ratepayers and users should be made to fund replacement assets or to suffer declines in the levels of services. This question is not being adequately addressed in the current bottom-up approach to formulating annual and medium-term capital budgets. Low-rating and low-debt local governments can only boast about their financial performance if they are also maintaining their asset bases.

Local governments need to change their funding paradigms. The parameters for capital budgets should not be driven by what is left over after the operating budget has been determined. If a local government does not have sufficient funds to maintain its existing assets, then it needs to make long-term strategic decisions to either increase funds for assets, or disinvest in assets and restrict services or service standards accordingly.

Recommendation

1. That all local governments:

- **complete the development of (and formalise) their asset management frameworks, as a priority**
- **link their capital budget process to their asset management plans**
- **implement systematic and consistent analysis of major new asset proposals through the requirement to prepare a comprehensive business case**
- **develop long-term funding strategies (revenue and debt) and cost reduction strategies to ensure they have the funds needed to renew assets and acquire new assets, in line with their asset management framework.**

RESPONSE provided by the Chief Executive Officer, Boroondara City Council

Incumbent councils are currently managing infrastructure renewal needs that have resulted from decades of underspending. In many cases, the ability of predecessor councils to sufficiently fund infrastructure renewal was directly hampered by policies of, and under-funding from State and Federal Governments. I am concerned that the report does not sufficiently acknowledge the significant effort of many councils in recent years to identify the renewal challenge faced and the leadership some local governments have given in funding the required renewal works. Boroondara, for example, faced up to the challenge over 4 years ago and in 2002-03 Council increased its total rate revenue base by 15 per cent.

At Boroondara, Council budget preparation occurs in conjunction with the development of a Council Plan. The Council planning process determines the priorities of a democratically elected council that seeks to address the needs and aspirations of its local community. Thus, having determined "what is needed", Council will prepare a budget to fund those priorities.

10.4 How well did local governments monitor their capital expenditure?

Given the level of funds spent each year on capital investment, it is important that local governments adequately monitor performance against their capital plans, and update their information and analysis in light of what actually occurs.

Having said this, we were concerned to observe that, as a whole, the local government sector failed to achieve its annual capital expenditure plans for at least the last 2 years. For example, while local governments collectively spent \$840 million in 2003-04 on capital investment, they budgeted to spend \$1.1 billion – representing an underspend of 24 per cent against budget.

In assessing whether local governments effectively monitored their capital budgets, we considered whether:

- projects were completed within the approved budget and in a timely manner
- project managers and council were provided with adequate and timely information to monitor the progress of capital projects.

10.4.1 Achievement against plans

We obtained data from each of the 9 local governments audited on their annual capital expenditures over the past 2 financial years. Consistent with the overall result for the sector, we observed that these local governments underspent their capital budgets by around 20 per cent for the past 2 years. The combined net underspend was \$50 million, from a planned spend of \$245 million. In other words, these local governments only delivered around 80 per cent of their budgeted capital works program over the 2-year period.

We observed a high degree of correlation of the underspend in each year across all the local governments audited. This indicates a system-wide difficulty in budgeting and capital management. To diagnose why or how councils can achieve such poor outcomes each year, we analysed the under and overspends on individual projects. This analysis gave us greater cause for concern.

When we examined project overspends, we observed that 40 per cent of all capital projects (representing 35 per cent of the total capital budget) were overspent. The average overspend was 29 per cent (\$24 million) when compared with the original budgets for these projects.

The major reasons provided by councils for the cost overruns included:

- the dollar rates for material and labour used to calculate initial cost estimates for the budget being less than the actual rates achieved – rates used in the budget were often derived from similar recently completed projects
- the scale and complexity of capital works being greater than apparent at the time the budget was approved – with detailed investigation and design only commencing or being finalised after the budget approval process
- changes to scope of works being approved after the budget – changes in scope arose because of public consultation commenced after the capital project had been approved, or because of specific requests by stakeholders/users.

Our analysis of capital projects which were underspent, indicated that the major reasons for underspends in each year were that projects had not progressed as much as expected, rather than that final costs had been less than budgeted. Around 10 per cent of projects that were underspent had not commenced in the year planned. On average, another 28 per cent of budgeted capital works were less than 50 per cent complete at year-end.

The major reasons advanced by councils for underspending capital budgets included:

- lack of effective forward planning, particularly at the design stage of project development
- delays in obtaining permits/licences/approvals from external agencies
- uncertainty in the availability of government grants, which are a significant source of capital funds for councils. Councils prepare their capital budgets, subject to government grants, but are uncertain when the grant will be approved and received.
- on-site latent conditions and inclement weather delays (particularly affects road works)
- key staff resignations.

The annual focus on capital spend and the need for an annual budget approval that may not be obtained until 2 months after the year has commenced, led to delays in commencing capital works and the deferral of projects.

Local governments also incorporate projects into their annual program which are conditional on receiving Commonwealth and state government grants. Should the grant not be received or not received in a timely manner, the project may not proceed, or funding from another project may have to be reallocated.

We were advised by the majority of local governments examined that the timeliness of the Commonwealth and state government grants capital works approvals process is a significant issue for local governments in developing their annual budgets and capital programs, as they may have to revise the capital budgets once the availability of government grants is known. Decisions on grants of this nature are generally advised to local government in September, after the annual budget process.

Conclusion

By their nature, capital projects present challenges in establishing reliable cost budgets and delivering on time.

The overspends incurred by all local governments highlight the need to obtain better data on which to estimate costs. More time and effort needs to be invested up-front to obtain a better understanding of likely actual costs. This may mean that capital budget planning needs to commence earlier in the year for the annual budget. The annual capital budget should be a product of the asset management plans, and its development should be tied to the long-term asset management planning cycle rather than the annual budget cycle.

The significant budget underspending on some projects highlights a degree of inflexibility in the capital budget process. All local governments examined approved their annual capital works program around July/August each year as part of the annual budget process. It is not until after councillors had formally approved the annual program that planning, tendering, and obtaining permits and approvals applications for specific construction/projects commences.

Recommendation

2. That all local governments:

- **review the timing of their capital budgeting processes to ensure sufficient time is allowed prior to the approval of the budget to obtain and analyse relevant data on estimated costs**
- **advance the timing of their budget approval process to allow for earlier commencement of approved capital projects.**

RESPONSE provided by the Chief Executive Officer, Warrnambool City Council

Recommendation partially agreed. Council supports the general thrust of the recommendations, however submits that the report is deficient in that many capital projects are funded by Federal or State Government, with funding agreements which impose reporting and completion timelines in relation to the provision of a grant.

The typically random announcement of grants by funding authorities often put councils in a position of disability in terms of both capacity and affordability to undertake sufficient investigation and design work to ensure high degrees of cost estimate reliability.

Secondly, Council is often required to place an allocation in its forward budgets prior to a commitment being made by a funding authority. If funding is not received, more often than not, the project will not proceed.

Councils are required to adopt 4-year Council Plans (including Strategic Resource Plans) and are urged to provide longer-term asset management plans, many of which are dependant upon significant government grants.

Clearly, it would be advantageous to the local government sector to have a solid and forward programmed level of commitment by all funding authorities, including possible 2-stage application processes, which would enable justification for significant expenditure to be allocated for investigation and developed design.

10.4.2 Monitoring and review

All local governments examined prepared some form of monthly progress reports of capital expenditure against budget for management, and quarterly reports for council review. All councils had undertaken formal mid-year capital program and budget reviews.

However, we identified a number of weaknesses in the monthly and quarterly reports, including:

- reports did not always include non-financial information such as planned project start and end dates, or the stage of physical completion of the project against which to compare actual expenditure
- they did not always report the total project budget or keep track of total project costs, over the entire life of the project
- reports did not generally distinguish or summarise expenditure between asset renewal/replacement projects and new asset acquisition projects
- analysis of cost variances was sometimes superficial, with minimal explanation of the reasons for cost overruns and delays.

The above deficiencies are brought into sharper focus when considering the delays and overspends experienced by local governments, as identified in our earlier analysis. There is every indication that the current management focus is on reporting progress in an annual sense against the annual budget, and less so on tracking individual capital projects over their lives.

Conclusion

Management reporting of capital projects requires improvement. Attention needs to be given to the financial and non-financial information included in capital expenditure reports.

Recommendation

- 3. That all local governments review their internal reporting practices to ensure reports capture cost and important milestone data for the life of each major capital project, as well as annual data.**

RESPONSES provided by Chief Executive Officers of the audited local governments

The local governments involved in the audit generally agreed with the report findings and recommendations. Two local governments provided more detailed comments, which are set out earlier in this report.



11. Review of Warrnambool City Council financial management practices



11.1 Overall conclusions

In June 2004, the Ombudsman referred a number of allegations to my office for enquiry about the adequacy of Warrnambool City Council's financial management practices. This report sets out the results of our examination of these allegations. In all, some 15 allegations were investigated covering the 13-year period 1992 to 2004.

While our investigation found the majority of allegations not to be substantiated, or unable to be substantiated due to insufficient evidence, a number of issues were identified, including:

- non-compliance with the *Local Government Act 1989* requirements relating to a major purchase (associated with the construction of the Koroit Street toilet block) and the funding of employee long service leave entitlements
- non-compliance with the Council's own procurement policies for 4 sizeable capital projects
- inadequate management and reporting of the 2002 and 2003 Fun 4 Kids festivals, which represent a major annual activity of the Council
- inadequate risk assessment during the early 1990s for some of its industry development and facilitation projects
- scope for improved management practices over certain major capital works projects and a rental property.

One of the allegations referred to us focused on the financial standing and sustainability of the Council. While the Council's reported results over the past 4 years show a strong financial performance and position, this has largely resulted from the receipt of significant capital grants over this period. After excluding capital receipts, the result is an underlying deficit, indicating that Council is not generating sufficient recurrent revenue to cover its costs of operations.

While the level of rates and charges raised by the Council is consistent with other regional cities, overall operating expenditure has been significantly higher. To be financially sustainable over the longer-term, Council needs to ensure that it is able to meet current operating costs from current revenue sources, and that its asset base is adequately maintained to ensure there is no deterioration in operating capability. It is, however, acknowledged that Council's asset management, as measured by the asset renewal ratio and the renewal and maintenance ratio¹, is consistent with the average for other regional councils.

The Council has in recent years implemented various continuous improvement initiatives, as part of the local government Best Value Program, aimed at strengthening its management practices and improving community outcomes. Some examples of the more recent initiatives that will help address a number of the above concerns include:

- implementation of improved budget setting processes
- establishment of a new expenditure committal costing system
- improved budget information on the Fun 4 Kids festival.

The Council has also implemented various initiatives to assist in better managing its short and longer-term financial sustainability, including:

- improved monitoring of cash flows
- conducting condition assessments of drainage assets and developing a strategy to ensure the sustainable provision of drainage services.

The Council's financial projections to the year 2008 predict a progressively improving operating result and funding position.

Notwithstanding these initiatives and projections, there remains a need for the Council to continually review and refine its governance and reporting arrangements, and its project management procedures. We make several recommendations in this regard.

¹ Further comment on these ratios is provided later in this report, in the part dealing with Council viability and sustainability.

RESPONSE provided by Chief Executive, Warrnambool City Council

Council welcomes the completion of this review and will give close consideration to all its recommendations. It is noted the review examines some 15 allegations made against Council, ranging over a 13 year period between 1992-2004.

Council notes that, of the 15 allegations made, at least 11 have been found to be not substantiated or wrong, also that the 3 found to be substantiated were administrative errors where corrective actions were taken and/or were reported in management letters as part of the Auditor-General's annual audit, then reported to Council's audit committee.

It is Council's contention that this independent review gives a "report card" which is not out of the ordinary within the local government sector, also noting Council has received unqualified external audit opinions over at least the past 19 years. Certainly, over recent years, Council has also evidenced high commitment and wide achievements in continuous improvement and leading practice.

It should also be recorded that the period 1992-2004 has involved major changes, including separation of the water function from local government, local government reform, removal of highway non-feasance and major changes in risk management, compliance activity and services assigned through legislative change.

11.2 Background

In June 2004, the Ombudsman, under the provisions of the *Whistleblowers Protection Act 2001*, referred a matter of public interest to me for possible investigation, involving allegations of mismanagement at the Warrnambool City Council. The allegations covered a broad range of topics, including:

- non-compliance with legislation and Council policies
- mismanagement of capital project budgets and timelines
- financial management issues, including the financial viability of the Council
- misleading or inaccurate reporting to the local community.

Following discussions with the Ombudsman's Office, I decided to examine these allegations under the authority of the *Audit Act 1994*.

11.3 Audit purpose and scope

Fifteen allegations were made, questioning the integrity, probity and management of a number of Council transactions and activities over the past 13 years. The purpose of the audit was to assess the validity of the allegations.

In investigating the allegations, additional work was also undertaken to determine if the practices alleged were more widely spread.

To assess the validity of each allegation, we examined relevant financial records and other documentation, analysed the current financial position and long-term financial viability of the Council and held detailed discussions with relevant staff and the current Mayor.

A management report dealing with all allegations was provided to the Council. By its nature, that report included the detail required for the Council to respond to our findings, conclusions and recommendations.

This parliamentary report draws the issues covered in the management report into a more concise form and incorporates the Council's response to the issues raised, consistent with normal practice. Substantively, all matters covered in the management report are also included in this report.

11.4 Compliance with local government legislation and Council policies

11.4.1 Tendering and procurement

Allegation: *In acquiring goods and services for the construction of the Koroit Street toilet block and the Logan's Beach whale viewing platform, the Council did not comply with legislative tendering requirements and its own procurement policy.*

Background

It is common practice in local government to outsource larger capital projects to external contractors who specialise in the provision of such capital works. This is normally facilitated through a tender process. Once a contract is signed with the external provider, they are responsible for delivering the product in accordance with the project specifications and at the agreed price.

Alternatively, the Council, using in-house or contract staff, may directly manage capital projects. In these circumstances, trade services such as carpentry, plumbing and electrical services are normally acquired through a schedule of rates contract. These contracts are generally used by councils for minor maintenance and repair work.

Each year, the Council advertises an invitation to tender for a range of services under schedule of rates contracts. Prospective suppliers submit a cost per hour quote for the specific services advertised. The successful tenderers are then added to the Council's approved supplier list and engaged as required, with contractors paid by the hour for work performed. Purchase orders are used to initiate and authorise the work to be undertaken by these contractors.

For purchases over \$100 000, the *Local Government Act 1989* requires the Council to go to public tender. The Council's 1999 procurement policy further required:

- use of a schedule of rates contract for purchases under \$5 000
- 3 written quotes for purchases between \$2 000 and \$30 000
- a formal tender process for purchases over \$30 000
- written authorisation from the chief executive for all purchases between \$20 000 and \$200 000, and from the Council for expenditure over \$200 000.

The Council's 2001 policy, which replaced the earlier policy, required:

- 3 written quotes for purchases between \$10 000 and \$50 000, in cases where a schedule of rates contract does not exist
- a formal public tender process for purchases over \$100 000, and for purchases between \$50 000 and \$100 000 where the chief executive has not authorised the purchase
- written authorisation from the chief executive for all purchases between \$50 000 and \$100 000 that were not subject to public tender
- schedule of rates contracts to be only used for purchases less than \$50 000 in value.

The Council's 2001 procurement policy does allow an exemption from the requirement to obtain quotes where there is only one supplier or there is an urgent need for the purchase of an asset². In these circumstances, a detailed explanation of the reason for the exemption is required to be attached to the purchase order.

² The exception to the policy does not apply to purchases over \$100 000.

To determine the veracity of the allegation made, we reviewed 4 capital asset acquisitions. These included the 2 acquisitions specifically mentioned in the allegations and 2 additional acquisitions selected to enable us to assess whether any inappropriate practices were more wide-spread. The acquisitions reviewed were:

- Koroit Street toilet block
- Logan's Beach whale-viewing platform
- Archie Graham Centre
- Cocks Pavilion.

For 3 of these acquisitions (the whale-viewing platform, the Archie Graham Centre and the Cocks Pavilion), the same contractor was engaged by the Council to undertake the required works.

Koroit Street toilet block

In June 2002, the Council decided to replace a below ground toilet block in Koroit Street, Warrnambool, with an above ground facility. In the following month, the Council obtained a quote of \$131 000 for the supply of the toilets and raised a purchase order for the acquisition.

Despite the toilets costing in excess of \$100 000, no formal public tender process was undertaken for the purchase and only one quote was received. There was also no explanation attached to the purchase order explaining why only one quote was obtained, as required by the Council's procurement policy.

After purchasing the prefabricated toilets on one purchase order and receiving one invoice, Council staff asked the supplier to split the original invoice into 2 separate invoices and created 2 new purchase orders to match these invoices. The Council's procurement policy specifically prohibits the "splitting" of invoices with the objective of overcoming the requirements of the policy.

We were advised by Council staff that the creation of separate purchase orders for each of the toilet units was not initiated to overcome the breach of Council officer authorisations, but rather as a "best solution" to overcome the breach of the *Local Government Act 1989* in relation to this procurement activity.

No planning permit was originally obtained for the construction of the toilet block as the Council considered that there was no requirement for a permit. However, Council's decision to obtain a planning permit after the toilets were purchased, contributed to the delay in their installation.

The Council contended that the purchase was for 2 separate units and that, as the cost of each was under \$100 000, there was no requirement for a public tender process.

We did not accept this contention. Given that the 2 units purchased were components of a larger asset (the toilet) and were purchased from the same supplier at the same time for the same site, it was difficult to argue they are separate and distinct assets. If this argument was accepted, there would be little need for the tendering requirements as most assets can be broken down to their component parts.

This issue was included in our 2003 management letter, provided to the Council, following the 2002-03 financial audit.

Logan's Beach whale-viewing platform

In 2000, the Council decided to construct a public viewing facility at Logan's Beach to enable members of the public to view whales in the bay. The project was originally estimated to cost \$208 000, but ultimately cost the Council \$330 000 to complete (including ancillary costs of \$96 000). This project was undertaken under the 1999 procurement policy.

The Council chose to directly manage this project and to procure the provision of carpentry services under a schedule of rates contract. It indicated that its reason for directly managing the project was due to:

- the difficulty in the construction task, given the location of the platform on sand dunes
- deficiencies in a design plan purchased from an architect
- scarcity of external providers, due to a building boom in Warrnambool at the time
- the potential for construction works to cease for unspecified durations during the whale-viewing period (typically around 4 months).

Each of the businesses providing goods and services to this project was paid directly by the Council, with the carpentry contractor who constructed the platform receiving \$53 000.

Council staff did not undertake a formal tender process for the carpentry work carried out on the whale viewing platform and the contractor was engaged without a purchase order, contrary to the Council's procurement policy.

In examining this project, we also noted that the carpentry contractor was not an approved Council contractor at the time he was engaged on the project³. The Council's actions created the potentially inequitable situation where other carpentry service providers, who may have submitted a complying tender for the schedule of rates, may have been precluded from providing services to the Council, while the contractor working on the whale-viewing platform was assigned work despite not submitting a tender.

The above action also resulted in it not having a formal agreement with this contractor. This may have created legal problems for the Council if there was a dispute over the work performed by the contractor.

Archie Graham Centre

In mid 2002, the Council decided to convert office space in its Archie Graham Centre into change rooms, using a contractor engaged under a schedule of rates contract. Council staff were not able to provide us with the contractor's quote for the proposed works on the Centre, but were able to obtain a copy of a quote from the records of the contractor engaged. This quote was for \$63 000. The final cost of the works was \$55 300.

As indicated earlier in this report, the Council's 2001 procurement policy did not allow for a schedule of rates contract to be used for expenditure exceeding \$50 000. For such expenditure⁴, the policy required the development of detailed specifications, a public request for quotation, 3 written quotes and a formal tender assessment process. None of these requirements were complied with.

Work completed on the Centre was billed under 2 separate invoices. We noted that a purchase order relating to work invoiced on 3 June 2002 did not contain a description of the works required to be undertaken and was dated 15 June 2002, some 17 days after the invoice was received. In addition, no purchase order was raised for an invoice dated 22 July 2002.

The Council's failure to raise and adequately complete purchase orders, and its approval of purchases after the goods/services were received, represented breaches of its procurement policy.

³ The person undertaking the work on the whale-viewing platform was not employed under any form of contract.

⁴ Where the chief executive has not approved the purchase.

Cocks Pavilion

Renovation works were undertaken on the Cocks Pavilion in 2001 at a cost of \$55 300. The procurement policy applicable to this project was the 1999 policy. Again, Council requirements were not met. No formal tender process occurred and the required approval of the chief executive for the purchase was not given. The work was instead approved by the Council's director, physical services.

We noted that a purchase order for a 26 June 2001 payment was not dated and the purchase order for a 26 October 2001 payment was dated 8 November 2001, 13 days after the invoice was received. Again, the approval of the purchase after the work was completed did not comply with the Council's procurement policy.

Conclusion

The Council did not comply with the tendering requirements of the *Local Government Act 1989* in relation to the purchase of the Koroit Street toilet block, and its own internal procurement policies for the construction of the Koroit Street toilet block, the whale-viewing platform, the Archie Graham Centre and the Cocks Pavilion

The Council used schedule of rates contracts to construct the whale-viewing platform and undertake works on the Archie Graham Centre and the Cocks Pavilion. Its practice of sourcing labour and materials for sizeable projects through schedule of rates contracts was not in compliance with its procurement policy, and exposed it to the risks associated with managing large construction works internally, such as cost overruns.

Recommendations

- 1. That processes be strengthened to ensure that all Council purchases comply with the requirements of the *Local Government Act 1989* and its own procurement policies, particularly the use of schedule of rates contracts.**
- 2. That all documentation supporting Council purchases is adequately completed and kept.**

RESPONSE provided by Chief Executive, Warrnambool City Council

Koroit Street Toilet Block

A fourth level officer ordered two non-identical prefabricated toilet units with a combined value of \$122 320 from the sole Australian importer of such units, without going to tender. The error was recognised and reported to the Auditor-General's agent as part of the 2003 annual audit, contained within the audit management letter and reported to the audit committee. Council's corrective actions were open and transparent.

Logans Beach Whale Viewing Platform, Archie Graham Centre, Cocks Pavilion

The issue primarily relates to the ability of a public body to undertake certain works by a schedule of rates contract. Council maintains that undertaking the relevant moderate/minor works by schedule of rates contract was both appropriate and cost effective.

Council supports the recommendations and:

- in early 2004, prior to the allegations being made, implemented updated control procedures for purchase approval, with additional authorisation required before an order is placed*
- is implementing an electronic contract register*
- will further review its procurement policy.*

11.4.2 Funding of long service leave entitlements

Allegation: *In the period July to August 2002, the Council used funds set aside for staff long service leave to pay for capital works. In doing so, the Council breached local government regulations, which restrict the use of funds set aside for employee long service leave payments.*

To ensure sufficient funds are available to meet long service leave entitlements, the *Local Government Act 1989* requires all councils to maintain an amount equivalent to the value of the entitlements of Council employees in a separate bank account, entitled the Long Service Leave Account. Until March 2003, the Council held these funds in a general investment account, but not a separate account as required by the Act.

As discussed later in this report, in 2001-02 Council embarked on an ambitious capital works program. During the period July to August 2002, delays in receiving grants for capital projects and approvals for borrowings created cash flow problems for the Council.

For 2 months in 2002, under the above circumstances, Council drew down the \$1.5 million set aside for the payment of employee long service leave, to meet Council costs. This amount was subsequently reinvested, following an increase in the Council's overdraft limit from \$300 000 to \$1.5 million in August 2002.

In October 2002, the Council's overdraft limit was reduced to \$300 000 after it received \$1.5 million in loan funding previously applied for. Since March 2003, Council has maintained a separate bank account for funds set aside for long service leave entitlements.

In July 2003, Council increased its permanent overdraft limit to \$1 million to facilitate seasonal fluctuations in capital works and cash flows.

Conclusion

We concluded that:

- even though an amount equal to the long service leave obligations was separately identified (as an investment) in the Council's books, the Council did not comply with the legislative requirement to maintain a separate bank account to hold long service leave funds until March 2003
- for 2 months in mid 2002, the Council inappropriately used funds set aside for long service leave to finance capital works, although these funds were subsequently reinvested in a separate bank account for long service leave.

RESPONSE provided by Chief Executive, Warrnambool City Council

Council acknowledges that an error occurred for a 2 month period (once in 20 years) under an exceptional circumstance. In 2002, Council was undertaking both the \$6.4 million Aquazone project and the \$5.4 million Flagstaff Hill Redevelopment project. As soon as Council became aware of the situation, it was immediately corrected, some 21 months before the allegation was made.

11.5 Reporting of Council operations to the local community

Allegation: *The Council knowingly released inaccurate financial information to the public, by advising the local newspaper that the 2002 and 2003 Fun 4 Kids festivals cost \$76 000 and \$150 000 respectively, whereas the actual costs were more than \$230 000.*

The annual Warrnambool International Fun 4 Kids festival has been held in the June-July school holidays for the past 6 years (1999 to 2004). Council organises and finances the festival.

Figure 11A details the budgeted and actual revenue and expenditure on the Fun 4 Kids festival for 2002, 2003 and 2004.

FIGURE 11A: FUN 4 KIDS FESTIVAL OPERATING RESULTS

	2002			2003			2004		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
	(\$)	(\$)	\$	(\$)	(\$)	\$	(\$)	(\$)	\$
<i>Revenue</i>									
Ticket sales, sponsorships, merchandise, etc	466 100	494 991	28 891 6.2%	746 425	555 182	(191 243) (25.6%)	457 820	412 161	(45 659) (9.98%)
<i>External expenditure</i>	496 700	642 001	(145 301) (29%)	703 751	723 556	(19 805) (2.8%)	538 060	518 176	19 884 3.7%
Profit/(loss)	(30 600)	(147 010)	(116 410) (380%)	42 674	(168 374)	(211 048) (295%)	(80 240)	(106 015)	(25 775) (32%)
Internal salary costs	(75 400)	(86 000)	(10 600) (14.1%)	(80 000)	(83 576)	(3 576) (4.5%)	(81 800)	(78 540)	3 260 4%
Net cost to Council	(106 000)	(233 010)	(127 010) (119.8%)	(37 326)	(251 950)	(214 624) (143%)	(162 040)	(184 555)	(22 515) (14%)

2002 Fun 4 Kids Festival

The net cost to run the festival in 2002 was \$233 000 (\$147 000 external costs and \$86 000 internal costs). This was \$127 000⁵ (120 per cent) in excess of the amount budgeted by the Council of \$106 000.

The Council produces a quarterly report of its operations and activities, which it also makes available to the local community. The purpose of this report is to enable Council to monitor its performance against budget and to approve variations to the budget.

⁵ Comprising of \$116 000 external costs and \$11 000 internal costs.

The \$116 000 budget overrun on external costs largely related to additional costs of engaging festival performers and paying for their accommodation. Of this amount, \$76 000 was reported in the September 2002 quarterly report (issued on 4 November 2002) and the remaining \$40 000 recorded in the December quarterly report under the heading "Festivals" (issued in January 2003.) The \$11 000 budget overrun on internal costs associated with holding the festival was included in the September report but not separately disclosed.

On 7 November 2002, the local newspaper reported that the festival cost ratepayers \$76 000. The Council advised us that:

- its September quarterly report did not disclose all of the \$116 000 budget overrun as it had not received invoices for all external expenditure incurred on the 2002 festival at the time of preparing the report
- information provided in these quarterly reports was the best available at that time, as an expenditure committal costing system was not established until April 2004
- the manner in which information is presented in the quarterly reports of the Council is consistent with that adopted by other councils.

We confirmed that the information disclosed in the quarterly reports was consistent with that recorded in the Council's financial records at the time the reports were prepared.

2003 Fun 4 Kids Festival

The 2003 Fun 4 Kids Festival, which incurred expenditure of \$723 000, was forecast to make a loss of \$37 000. The net cost to Council of running the festival was \$252 000, 143 per cent more than budgeted.

The Council's September quarterly report issued in October 2003 reported a budget variation of \$210 000, taking the external cost of running the festival to \$166 000. This figure excluded \$2 000 of external costs⁶ and internal staff costs of around \$84 000. On 11 August 2003, the local newspaper reported the net cost of the festival at \$150 000.

We confirmed that the information disclosed in the quarterly reports was consistent with that recorded in the Council's financial records at the time the reports were prepared.

⁶ This amount was not recorded in the financial records of the Council at the date the quarterly report was issued.

Revenue from ticket sales was budgeted to be \$439 000. This amount was determined on the basis of a 25 per cent increase in the number of ticket sales over the previous year and a 50 per cent increase in the average price of the tickets. The number of festival visitors in 2002-03 was 18 300 and festival visits 31 000 (as the festival runs for 3 days, visitors can visit the festival on more than one occasion). These attendance figures were virtually the same as for the 2002 festival.

In late 2003, the Council engaged an external consultant to review the management of the 2003 festival. An analysis undertaken by the consultant of the visitor numbers against ticket revenue identified some anomalies. This analysis indicated that the actual revenue from ticket sales of \$278 000 should have been up to 22 per cent (\$60 000) more than collected. Possible explanations for the shortfall in expected revenue included:

- inaccurate attendance figures
- complimentary tickets exceeded the planned allowance of around 9 per cent
- some money received from ticket sales not being banked.

The report prepared by the consultant highlighted a number of concerns with the festival, namely:

- Council's aim to have a self-funding festival was not achievable in the short-term. For the next few years at least, the festival is likely to require Council financial support of around \$100 000 per year
- the accuracy of information collected on the 2003 festival was questionable
- inadequate controls over ticketing and the handling and recording of cash
- deficiencies in project planning and budgeting processes for the festival.

The report made wide-ranging recommendations to improve the management and operation of the festival, including:

- implementing risk management processes in areas of financial management, succession planning, commercial transactions, reporting and accountability
- establishing an appropriately structured organising committee with set objectives and strategies
- improving financial reporting
- a more robust rationale for future budget figures to provide greater certainty that the budgeted figures can be achieved
- reviewing various data and recording processes to ensure appropriate transparency
- establishing realistic but conservative targets for ticket sales and the exercise of caution in issues relating to expenditure.

Our 2003 external audit management letter raised a number of these issues.

2004 Fun 4 Kids Festival

Following receipt of the above-mentioned external report, a number of changes were made to improve the way in which the festival was run. For example, the Council entered into arrangements with the Warrnambool Entertainment Centre, to provide on-line ticketing, to manage all ticketing for the 2004 festival. This allowed Council to better account for tickets issued in 2004 and enabled a reconciliation with revenue received to be undertaken.

Council also upgraded its management information systems to provide more timely and accurate recording and reporting on the festival.

The cost to the Council of the 2004 festival was \$185 000, some 14 per cent in excess of budget, but substantially less than the 2 preceding years.

The improvement in the Council's performance against budget is largely due to a more realistic estimate of the external costs likely to be incurred by the Council.

Overall conclusions - Fun For Kids Festivals

The costs of running the 2002 and 2003 festivals, reported in the local newspaper, were significantly less than the net costs incurred by the Council. The Council was aware that this information was of interest to the Warrnambool community and should have known that the cost of running the festival was likely to be considerably more than this amount. Despite this, no attempt was made by the Council to inform the newspaper of the likely final cost of the festival.

While these festivals are designed to achieve positive community outcomes, they are generally dependent on Council contributions towards their operating costs. Such contributions are provided on the basis of firm project budgets. However, our review of the 2002 and 2003 festivals disclosed that the Council has not been able to keep their costs within budget. Possible reasons for this situation include:

- deficiencies in the Council's budget setting processes and/or
- the Council's inability to effectively manage ongoing external commitments leading up to and during the festivals and/or
- the Council setting conservative budgets to help ensure that the festival continued.

The budget setting processes for the 2004 festival improved on prior years, resulting in expenditure outcomes closer to budget for that year. However, the cost to Council of running the festival was still substantial.

Our review of the festival over the 3-year period also disclosed that:

- While there was a strong public interest in the cost incurred by the Council in running the festivals, it was not possible, on the information made available by it (in the quarterly and other reports), for external parties to identify this cost.
- Prior to 2004, there were problems with the financial information generated on the festival and its overall management, particularly in relation to controls over admissions and cash receipts. For example, an analysis of the ticket revenue against admissions information for 2003 identified a revenue shortfall of around 30 per cent (including complimentary tickets). The Council subsequently took action to address these issues following receipt of the consultants report.

Recommendation

3. That the Council:

- **continues to refine its budget setting processes to ensure that future submissions to Council supporting the running of the festival, accurately reflect the likely costs and benefits of the festival to the Council and the local community**
- **closely monitors commitments against budget during the planning phase of the festival, and payments during the festival**
- **closely monitors the controls over the festival ticket sales to ensure all revenue generated from the festival is collected**
- **improves the format and content of its quarterly reports so that readers of these reports are better placed to determine the net annual cost to the Council of major activities/operations such as the Fun 4 Kids festival**
- **periodically reviews the overall costs and benefits of holding the festival with a view to reducing the net cost to the rate paying community.**

RESPONSE provided by Chief Executive, Warrnambool City Council

Council notes that the actual allegation is incorrect.

Council recognised the need for improvements in the planning and operation of the Fun 4 Kids Festival and undertook a comprehensive review following the 2003 Festival. The 2004 Fun 4 Kids Festival was largely in accordance with the budget.

RESPONSE provided by Chief Executive, Warrnambool City Council - continued

On the matter of financial information, Council prepares publicly presented quarterly reports that include **known** budget variations for approval. This does not include estimates only as formal budget variations. The information contained in the 2002 September Quarterly Finance Report was exactly as per the financial ledger, then subsequently appearing in the local press. The review is silent in not clarifying that the local press article of 11 August 2003 did not arise from any Council report or publication.

Council supports the recommendations and confirms that changes implemented following the 2003 festival included:

- refined budget setting and management processes
- changes to ticketing procedures
- re-appraising the purpose and net benefits of the festival.

11.6 Managing major capital works projects

Allegation: Council members were provided with misleading financial information on 3 capital projects. Specifically:

- unjustifiable project budgets were initially submitted to gain Council approval, often without recognition of associated current costs
- there were significant variances between approved capital budgets and original budget estimates.

The Council's process for approving large capital projects generally involves:

- estimating the likely cost of the project through an initial budget or forward estimate
- developing a business plan for the project, including project lifecycle costs
- approving a post tender budget.

We examined the Council's capital budgeting procedures for 3 projects. Our findings follow.

Warrnambool Aquatic Leisure Centre (AquaZone)

In 1994, the Council first considered constructing an indoor heated pool at a cost between \$3.75 million and \$6.40 million. Over the following 6 years, various design options and funding models were considered. However, it was not until April 2001, that the Council formally approved a post tender budget of \$6.15 million.

The Aquatic Leisure Centre officially opened in September 2002. It cost \$6.69 million, \$540 000 or 9 per cent more than the post tender budget, with some of the overrun due to additional works of \$298 000 not included in the original budget.

On 19 December 2002, the contractor engaged to construct the centre formally requested that the Council pay an additional sum of \$670 000 plus interest. This claim related to additional works not included in the original contract and delays over a 7-month period due to the late receipt of Council approvals.

On 4 April 2003, the Council's solicitors estimated that the Council owed the contractor between \$140 000 and \$260 000 (including costs) and that they should make an initial settlement offer of between \$60 000 and \$100 000. The Council made an offer of \$80 000 in early 2003, but no further offer was made until December that year.

Despite ongoing negotiations, the dispute could not be resolved and the contractor invoked the arbitration clause provided in the contract with Council. On 30 March 2004, at mediation, the dispute was finally settled. The Council agreed to pay the contractor \$400 000 and both parties agreed to pay their own legal costs.

The Council incurred \$542 000 in associated legal fees between September 2002 and June 2004, and \$10 000 for arbitration costs.

The \$942 000 in additional costs on this project were met from funds made available by deferring work on other capital projects and generating cost savings from other Council programs. With the exception of \$85 000, which was included as part of the cost of the asset recorded in the Council's financial records, these additional costs were expensed.

Warrnambool Indoor Multi-Purpose Stadium

In November 1998, the Council decided to build a new multi-purpose stadium. The Council's forward estimates recorded the cost of the stadium at \$1.1 million, subject to further investigation about the scope of the project and its location.

In August 2000, following an external consultant's report and analysis of funding sources, Council approved a post tender budget of \$3.21 million. Construction of the stadium was completed in mid 2001.

The stadium cost \$3.14 million to construct, representing a saving of \$70 000 against the final post tender budget estimate.

Flagstaff Hill Redevelopment

In 1999, plans for the redevelopment of Flagstaff Hill were submitted to Council members for approval. The proposed redevelopment, which forms part of the Flagstaff Hill Maritime Village overlooking Lady Bay in Warrnambool, included a visitor information centre, museum, restaurant and bar area.

The Council's November 2000 business plan estimated that the redevelopment would cost around \$5.3 million. In May 2001, after further investigations, the Council formally approved a post tender budget of \$5.735 million for the redevelopment.

The project was completed in December 2003, some 3 months ahead of schedule. The redevelopment of Flagstaff Hill cost \$5.473 million, \$262 000 less than the post tender approved budget.

Overall findings - all projects examined

Capital costs

For each of the above capital projects, initial budgets for the construction of each facility were prepared and potential funding sources identified. These budgets varied from those formally approved by the Council as a result of changes in project scope and availability of funds, and followed the completion of additional feasibility studies. These initial budgets were included in the Council's 5-year budget projections.

The final budgets for the construction and development of AquaZone, the indoor sports stadium and redevelopment of Flagstaff Hill were established when the Council formally adopted the post tender budgets. It is against these formally approved budgets that actual project results are compared, by the Council, to identify variances from budget.

Council minutes evidenced that Council:

- monitored the various stages of the feasibility/planning process, including project costings and funding sources
- considered and approved changes to the scope of the projects.

Lifecycle costs

Council policy also requires that business plans be prepared to support all major capital project proposals submitted to Council for approval, which are to include the full project lifecycle costs. Our review of these business plans indicated that:

- a business plan was not prepared for the indoor stadium
- projected operating revenues and expenses were limited to 5 years for Flagstaff Hill and 3 years for AquaZone
- internal costs, financing costs, depreciation and disposal expenses were not included in the AquaZone plan.

We examined the 2003-04 operating revenues and expenditure for each of the 3 above projects to assess their impact on Council finances. We noted that the revenues and costs for each project did not differ materially from the Council budget estimates. However, of the 3 projects, only AquaZone managed to generate an operating profit in 2003-04 (\$138 000) and achieved a better net operating result than originally budgeted.

The indoor stadium and Flagstaff Hill made operating losses of \$66 000 and \$132 000, respectively, and have not made a profit since they opened in 2001 and 2003. This was despite the business plan for Flagstaff Hill predicting operating profits for the first 5 years of its operation, including a \$275 000 profit in 2003.

Overall conclusions - all projects examined

Proposals for new capital projects are put to the Council from time to time and adopted in principle with only preliminary work completed to estimate their likely cost (initial budget estimate). It is then common for such projects to be resubmitted to Council, with amended budgets once the scope or costings become clearer. While this process will invariably result in approved post tender budgets varying from initial budget estimates, we found no evidence of initial budget estimates being deliberately set low to gain Council approval for the project.

We consider that in order for Council staff to make informed decisions regarding the acquisition of capital assets, they need access to reliable information on the likely costs incurred and benefits generated from these assets over their useful life. Relevant information would normally include design, acquisition/construction, finance, operating, maintenance, depreciation and disposal costs.

While all 3 capital projects were delivered substantially within the approved post tender budgets established for design and construction, the Council had not identified all costs associated with these projects over their useful life.

Our review of these projects also identified the following issues of concern:

- Although legal disputes are seldom straightforward, from the evidence available on the Aquazone dispute, it is difficult to understand why it continued for almost 12 months, resulting in the accumulation of legal costs to over \$500 000. For an organisation the size of Warrnambool Council, this expenditure is significant and represents a major impost on ratepayers
- The Council's decision to commence a number of large capital projects around the same time was largely driven by the availability of external grant funding. However, the decision created considerable pressure on Council staff to adequately manage these projects and impacted on the financial viability of the Council.

Recommendation

4. That, in future:

- **capital project proposals, which are considered by Council as part of its project approval process, include the whole-of-life costs associated with the project (capital costs, financing, operating and maintenance costs) and that these costs be subsequently input into future Council budgets**
- **care is taken to ensure that information provided in framing Council budgets is as reliable as possible**
- **when the Council is involved in contractual dispute, it should endeavor to quickly assess the likelihood of it successfully defending an action. This will help ensure that timely decisions are made by Council on the appropriate action to be taken in relation to a dispute, thereby reducing administration and legal costs.**

RESPONSE provided by Chief Executive, Warrnambool City Council

Council notes the review concludes "...we found no evidence of initial budgets being deliberately set low to gain Council approval for the project". Council therefore notes that the actual allegation is not substantiated.

It is considered that the review is relatively marginal in its appreciation of mandated processes (including professional services costs) when another party refers to a building contract dispute to arbitration.

The recommendations are supported. Council has also taken action in strengthening project management policies and procedures, prior to allegations being made.

11.7 Industry development and facilitation projects

Under Section 193 of the *Local Government Act 1989*, councils are permitted to undertake certain activities, including the provision of assistance to businesses and other organisations in the local community. Prior to undertaking such activities, a council must first obtain the approval of the Minister and the Treasurer.

Allegation: *The Council was slow in determining an appropriate use for the former Brierly hospital site, which it purchased in the late 1990s. The site represents a public liability risk and incurs ongoing security costs. The Council has no clear plan for the future of the site.*

In 1999, Council purchased 21.68 hectares of the former hospital site from the Department of Human Services for \$110 000, with Council assuming responsibility for any demolition of the decommissioned buildings and any environmental remediation requirements. The state government owned the remainder of the property.

Over the next 4 years, Council carried out a number of feasibility studies jointly with various government agencies to determine the best use of the property. This process proved lengthy and protracted.

In August 2003, agreement was reached with the Department of Treasury and Finance for the joint sale of the majority of the site. The property was eventually sold on 27 August 2004 for \$4.2 million, with the Council's share amounting to \$2.1 million. In addition, Council retained public open space with an approximate value of \$2.7 million.

Conclusion

The Council purchased this site as a strategic investment for the local community, holding the property for almost 5 years before disposing of it. While we were not able to determine whether the property should have been disposed sooner, its sale in August 2004 provided a very positive financial outcome for the Council.

Allegation: *The Council purchased a woollen mill to allow the previous owner to keep the mill open. When the owner ceased trading, the Council was left with a contaminated property, with no requirement on the former owner to contribute to clean up the site. The Council generated no return on its investment and will be unlikely to recover its acquisition costs.*

In January 1995, Council purchased a woollen mill and an associated property for \$1.04 million (\$800 000 for the Harris Street mill site and \$240 000 for lot 28 Dickson Street). These properties were acquired to support the business, which was struggling under its former owner, and to minimise the impact of major staff redundancies in the local industry. The Council obtained Ministerial approval for the purchase.

The decision to purchase the mill was made without an assessment of the potential liabilities associated with the purchase, such as remediation works required to meet relevant planning and environmental requirements.

In January 1995, the Council also entered into a 5-year lease agreement (including a 5-year renewal option) with a tenant, to rent the mill. In July 2000, the tenant decided not to take up the renewal option, choosing instead to close the mill. As the Council was unable to secure a new tenant, it decided to dispose of the property.

The Council sold the mill site in February 2003⁷ for \$750 000, incurring a loss on sale of \$50 000⁸. An environmental report included in the sale contract transferred responsibility for the clean up of the site to the purchaser. Clean up costs were estimated to be around \$1.25 million, with a separate estimate of \$1.5 million for demolition costs.

The Council subdivided the Dickson Street property and developed an industrial estate on the site. The subsequent sale of the industrial blocks generated a profit of \$977 000 for the Council.

Conclusion

From a financial perspective, the purchase and subsequent sale of the 2 properties was successful, generating in excess of \$900 000 profit for the Council. However, by not undertaking an evaluation of the site prior to its purchase, the Council could have unknowingly exposed ratepayers to risks associated with the purchase.

⁷ Settlement for the sale occurred in October 2004.

⁸ It should be acknowledged that the loss on sale does not include the revenue earned by Council from leasing out the mill site, or the opportunity cost of the capital invested in the property.

Allegation: *That the Council's acquisition of the Fletcher Jones property in Warrnambool was a poor decision as it transferred responsibility for the safe demolition of buildings on the site (estimated to be \$1.5 million) to the Council.*

In May 1992, the Council purchased the Fletcher Jones factory site located at Pleasant Hill for \$750 000. The 2.3 hectare site was purchased to help the Fletcher Jones Corporation trade out of its financial difficulties and to preserve 300 jobs locally. This was in a period of very high unemployment in the region.

It was intended that Fletcher Jones would continue operating under a lease arrangement for 3 years with options of 2 further terms of 3 years. The Council currently has lease arrangements with 4 separate parties that occupy the site, including Fletcher Jones.

An external report prepared for the Council in July 2003, indicated that the roofs of buildings on the site were predominately constructed with sheeted asbestos and estimated the cost to demolish these buildings at \$1.63 million.

The Council's 1 January 2004 municipality valuation of the site records a capital improved value of \$1.13 million (being the sum of 3 assessments relating primarily to existing occupancies, but not taking into account external areas within the property, not subject to an occupancy). This valuation is based on current conditions and does not take into account any redevelopments or demolition/clean up costs.

Over the past several years, the Council has been evaluating the potential uses for the site. It recently commenced a sale process that will most likely entail a rezoning and significant redevelopment of the key highway site.

Conclusion

Until the rezoning process is completed, it is not possible to determine whether the Council's purchase represented a sound financial investment. However, it is clear that the acquisition benefited the community in facilitating the retention of local employment opportunities.

Overall conclusion - Industry development and facilitation

Each of the purchases we examined fall into the category of regional economic development and industry facilitation, which is specifically allowed under the powers given to local councils under legislation.

Our review concluded that the acquisition of each property was well intended and designed to support the local economy and community. The acquisitions also did not result in any significant application of Council resources or adversely impact on local ratepayers. However, by their nature these projects contain elements of risk, which the Council must manage.

The outcome of these purchases was largely positive from a financial prospective, however, by not evaluating each property prior to its purchase, the Council may have unknowingly exposed ratepayers to risks.

Recommendation

- 5. Where the Council considers investing in future industry facilitation activities, any decision to acquire assets is preceded by sufficient analysis and risk assessment to provide Council members with information to make informed decisions on the long-term benefits and risks of these acquisitions.**

RESPONSE provided by Chief Executive, Warrnambool City Council

It is noted the 3 allegations in this area have been found to be not substantiated, or wrong.

Council believes that the review tends to not appropriately look through the "eyes of the day" regarding Council's purchase of the Fletcher Jones and Woollen Mill sites in 1992 and 1995, respectively (both for low figures but as "going concerns") in order to preserve 380 jobs in the local community.

Council supports and is already implementing the recommendation in any industry facilitation activities.

11.8 Lease arrangements

Allegation: *The Council bought back a lease in the Flagstaff Hill Maritime Village at an inflated price of \$200 000, instead of cancelling the lease for non-payment of rent, as it was entitled to do.*

From 1989 to mid 2003, an area within the Flagstaff Hill Maritime Village was leased or sub-leased to various parties to operate the Mahogany Ship Restaurant. Over much of this time, the restaurant was not financially successful, resulting in tenants regularly defaulting on their rental payments.

Since 1997, a number of studies and feasibility reports for the redevelopment of Flagstaff Hill were prepared. In August 1999, a strategic plan for the redevelopment was submitted to Council.

The tenant's failure to pay rent on the leased property resulted in the Council taking action to cancel its lease agreement in October 1999. However, instead of removing the tenant, the Council allowed the tenant to continue operating until March 2000, provided they sold the business and the new tenant paid the outstanding rental. In April 2000, the Council and a new tenant entered into a 5-year lease, with a further 5-year option and the outstanding rental was paid.

In June 2000, external consultants were engaged by the Council to prepare a master plan for the redevelopment of Flagstaff Hill, which was provided to the Council in July 2000. As the proposed redevelopment included the floor space occupied by the restaurant, it was highly likely that the Council would need to assume control of the area occupied by the restaurant.

In September 2000, the tenant started falling behind in rent payments. After numerous unsuccessful attempts to recover back rent, on 30 April 2001 the Council served a notice to remedy on the tenant, requiring payment of all outstanding rental within 14 days⁹.

In May 2001, the state government indicated to the Council that it would be eligible for a grant of \$3.3 million for the redevelopment of Flagstaff Hill. This led to the Council significantly altering the scope of the redevelopment.

On 30 May 2001, the Council advised the tenant that the lease was forfeited for non-payment of rent and that it required vacant possession. At the same time, the Council offered to forego rental arrears in exchange for the tenant vacating the premises by 15 June 2001.

On 8 June 2001, the tenant paid the Council \$42 800 as full payment of its rent arrears. Following receipt of the arrears, the Council sought further legal advice on whether to accept the arrears. Its solicitors advised that if the payment was not accepted, the tenant would probably appeal to the Supreme Court against the forfeiture of the lease and, if the only breach of the lease was the non-payment of rental, the court was likely to reinstate the lease. Based on this legal advice, the Council informed the tenant that it would not terminate the lease and, through a third party, entered into an agreement to purchase the lease for \$220 000.

⁹ Action taken by the Council was based on advice obtained from its solicitors.

After the purchase of the lease, the Council took possession of the leased premises and operated the restaurant until 31 December 2001. It then entered into an agreement with a new tenant for the short-term lease of the premises. The new tenant also had difficulty in meeting its rental payments. After its attempts to recover the outstanding rental failed, the Council took the tenant to court and obtained a judgement against the tenant for \$26 000 in rental arrears.

On 12 March 2002 the Council approved the contract for the redevelopment of Flagstaff Hill, with work commencing in the following July.

A number of decisions taken by Council may have impacted on its legal rights under the lease agreement and its ability to terminate the lease entered into in April 2000 with the tenant. Specifically:

- Under the lease agreement with the tenant, the restaurant operated for around 4 months (until September 2000) before falling behind in rental payments. However, it was not until 30 April 2001, some 7 months later (during which various unsuccessful attempts were made by Council to collect the outstanding rent), that a notice to remedy was served on the tenant.
- The tenant should have been formally notified on 14 May 2001 (14 days after the notice to remedy was served) that their rights under the lease were forfeited for non-payment of rent. Notification was provided on 30 May 2001.
- Given the tenant forfeited any rights under the lease and was legally bound to pay rental arrears, offering to forego rental owing was likely to confuse the tenant and undermine the rights of the Council as landlord.

The Council advised us that the previous tenants experienced difficulties in meeting the rental payments. Council actively sought to manage the lease with the tenant while at the same time recognising the importance of having an operating restaurant and tavern at the entrance to its Flagstaff Hill Maritime village.

Conclusion

Over a considerable period, the Council experienced difficulties in ensuring tenants of the Mahogany Ship Restaurant paid their rental on time.

The redevelopment of Flagstaff Hill was under consideration by the Council for much of the late 1990s. In these circumstances, it is difficult to understand why the Council chose not to remove the defaulting tenant from the premises in April 2000 and leave the premises vacant until it had finalised its redevelopment plans.

In respect of the lease entered into by the Council in 2000, the Council's action in not issuing the tenant with notice to remedy earlier and its handling of a tenant in default of his rental agreement, may have contributed to the ultimate need for it to buy back the lease from the tenant.

The purchase price of \$220 000 paid by the Council for the lease and shop fittings was 22 per cent higher than the tenant paid for the business (including fittings and goodwill) and the lease in 2000.

We acknowledge the legal advice indicating that once the tenant paid the rental arrears, the Supreme Court was likely to reinstate the lease. As a result, the Council was committed to buying back the lease if it wanted to take possession of the property.

RESPONSE provided by Chief Executive, Warrnambool City Council

Council acted on legal advice in relation to this matter and notes that the review states "we acknowledge that the legal advice indicating that once the tenant paid the rental arrears, the Supreme Court was likely to reinstate the lease".

Council does not accept conjecture within the review which infers that the timing of Notice of Remedy on either the first or the second tenant would have achieved simple forfeiture of the lease (with loss of business sale opportunity) as this has no basis in business logic.

11.9 Planning issues

Allegation: *The Council strategic planning is ineffective and inefficient. Despite 6 major studies on the Warrnambool foreshore in the past 10 years, no significant initiatives/developments resulted from any of the studies completed.*

From time to time, as part of its strategic planning processes, the Council undertakes planning studies. These studies provide it with information such as the condition of Council controlled assets, community needs and development opportunities. They also assist Council in the development of longer-term strategic plans.

The Council implemented a reporting system to monitor the progress of its major activities, including strategic studies. At the date of preparing this report, information on only one of these studies, the Warrnambool Foreshore Plan, was recorded in this system.

Details of the studies we examined and the expenditure incurred to the date of our audit on development work arising from the studies are provided in Figure 11B.

FIGURE 11B: STATUS OF STUDIES ON THE WARRNAMBOOL FORESHORE

Study	Purpose of study	Expenditure to date (a) (\$'000)
Warrnambool Foreshore Management Plan (1995)	To outline the Council's vision for the Warrnambool foreshore reserve	400
Warrnambool Foreshore Urban Design Framework and Coastal Action Plan (Framework study originally prepared in April 1999 and later updated to include the coastal action plan)	Identify future land use and development opportunities. The study was expanded to include a broader Victorian coastal strategy	960
Warrnambool Breakwater Condition Inspection (1998)	Determine the condition of the Warrnambool breakwater and to identify any remedial works	280
Warrnambool Harbour Siltation (1999)	Examine the wave and wind driven energy systems that operate in Lady Bay	125
Warrnambool Harbour Precinct Plan (2003)	Redevelop the Warrnambool yacht club site	Nil

(a) Expenditure incurred to the date of the audit on the implementation of the relevant studies.

Conclusion

While the Council has made some progress in delivering the outcomes proposed in its planning studies, there appear to be long delays between the planning of future development and the actual development taking place. To some extent, this is explained by the need for the implementation of the recommendations to be considered against the other expenditure priorities of the Council.

Further, the sensitive environmental nature of much of the foreshore land subject to the planning studies, requires ministerial approval under the *Coastal Management Act 1995* for any development, and the Council to obtain support from other major stakeholders, such as state government departments and heritage groups. Some of this land is also subject to native title issues, which must be resolved prior to any development commencing.

Recommendation

- 6. That the Council includes information on all strategic studies in its new reporting system and periodically provides Council members with progress reports on the implementation of Council planning strategies.**

RESPONSE provided by Chief Executive, Warrnambool City Council

The review recognises the challenges and delays that can occur in managing coastal Crown land which is also frequently subject to native title issues. Council notes that the allegation is not substantiated.

The recommendation is being progressively implemented, such action being taken before the allegation was made.

Allegation: *In not relocating the truck wash located at the Warrnambool saleyards, the Council was in breach of a planning permit it obtained for the redevelopment of the Warrnambool indoor multi-purpose stadium.*

The Council's decision to locate its new stadium next to the Warrnambool saleyards, significantly increased traffic congestion in the surrounding area. To address this problem the stadium planning permit, issued on 16 March 2000, included a requirement to upgrade the intersection at the entrance to the stadium. It did not require the relocation of the saleyard truck wash.

However, instead of undertaking the required road works, the Council decided to reduce the traffic congestion at the intersection by relocating the saleyard truck wash.

Despite the stadium being opened in July 2001, the truck wash was not relocated as planned and, as a result, the road congestion issue was not resolved. Council staff informed us that VicRoads have now agreed to now fund the intersection works specified in the planning permit. This means that the truck wash no longer needs to be relocated.

Conclusion

The normal practice is for developers to comply with the conditions of their planning permits before final approval is provided to operate the development. In respect of the stadium, it was operational for over 3 years, yet the intersection works, required by the planning permit, are still to be completed.

 Recommendation

- 7. That, for future Council managed developments, all planning permit requirements are complied with prior to the development being put into use.**

RESPONSE provided by Chief Executive, Warrnambool City Council

Council has been in ongoing discussions with VicRoads relating to overall traffic management along the declared road adjoining Warrnambool Stadium. VicRoads approved a new traffic management plan in late 2004, now enabling a minor amendment to the Warrnambool Stadium planning permit to be sought.

Council notes that the allegation is incorrect as VicRoads has now varied traffic management arrangements relative to the situation when the relevant planning permit was issued.

Council supports and will implement the recommendation.

11.10 Compliance with tax requirements

Allegation: *Prior to 1999, the Council knowingly did not pay sales tax on motor vehicles it purchased and provided to staff members as part of their remuneration package.*

Our investigation found that the Council had not paid sales tax on 15 motor vehicles purchased for employees as part of their remuneration packages during the years 1996 to 1999. The Council's decision not to pay the tax on these vehicles was based on its interpretation of the tax legislation. Sales tax ceased to apply at the end of 1999 with the introduction of the goods and services tax (GST).

The Council could not provide evidence to audit to support the assertion that these vehicles were sales tax exempt and conceded that the previous sales tax treatment was inappropriate. They also advised us that, once the mistake was identified by its staff in 1999, the practice was discontinued. At the date of preparing this report, the sales tax payable on the above vehicles was not paid.

Conclusion

We were unable to conclude on the matter of intent, that is, whether the Council at the time mistakenly believed the vehicles were exempt from sales tax or knowingly did not pay the tax.

The Council's action in not paying the sales tax on the purchase of the afore-mentioned vehicles, during this period or subsequently, may have exposed it to penalties for breaches of the tax legislation.

RESPONSE provided by Chief Executive, Warrnambool City Council

The allegation relates to Council knowingly not paying sales tax on motor vehicles. It is noted that the review concludes “we are unable to conclude on the matter of intent, that is, whether the Council at the time mistakenly believed, the vehicles were exempt from sales tax or knowingly did not pay tax. Council maintains that the error was a matter of incorrect interpretation and considers there is no evidence to support the allegation.

Allegation: *In 2001, the Council authorised an arrangement for staff to purchase desktop computers as part of salary sacrifice arrangements. A senior manager issued an instruction to finance staff indicating that the computers were laptops and therefore not subject to FBT, even though he was aware that the computers were desktops.*

Under the *Fringe Benefits Tax Assessment Act 1986*, provision of a laptop computer to an employee is deemed an exempt benefit and therefore not subject to FBT. Exempt benefit status does not apply to computers classified as desktops.

In June 2001, the Council entered into an arrangement with 36 staff to enable them to purchase desktop computers from a third party supplier. Under the arrangement, staff were provided with loans to purchase computers. The staff made repayments on these loans over 2 years. These repayments were deducted from the pre tax income of staff, effectively making them tax exempt.

On 25 June 2001, a senior Council officer issued a memo to the Council’s paymaster indicating that FBT was not payable on these computers as they were laptop computers and therefore exempt from FBT. Even though the memo stipulated that there was no requirement to pay FBT on the computers purchased, \$4 500 was paid by the Council as FBT for the period from 2001 to 2004, on the basis that tax was in fact payable on these items.

This matter was first brought to the attention of the chief executive in April 2004, 3 years after the event. The chief executive sought an explanation and issued a formal reprimand to the Council officer that recommended the practice.

Conclusion

A Council officer did issue an instruction that FBT was not to be paid on the computers because they were laptops. However, the computers were desktops and therefore subject to FBT.

It is reasonable to assume the Council officer that recommended the above practice knew the difference between a desktop and a laptop computer. Therefore, his direction issued to the paymaster appeared a deliberate attempt to make the non-cash benefits provided to staff exempt from FBT. It also represented non-compliance with FBT requirements.

Had the Council not subsequently paid the tax, this action could have exposed it to penalties for breaches of the *Fringe Benefits Tax Assessment Act 1986*.

RESPONSE provided by Chief Executive, Warrnambool City Council

Council acknowledges that an incorrect internal memorandum was issued. However, corrective action was taken and the correct FBT was paid over 3 years before the allegations were made.

Recommendation

8. That the Council:

- **liaises with the Australian Taxation Office to determine if it has any outstanding tax liability in relation to the sales tax payable on motor vehicles purchased before 1999**
- **establishes a periodic review process to ensure ongoing compliance with all tax requirements, including those related to benefits provided to employees as part of their remuneration.**

RESPONSE provided by Chief Executive, Warrnambool City Council

Council will implement the recommendations.

11.11 Council financial viability and sustainability

Allegation: *The extensive capital works program undertaken over the past few years adversely affected the Council's financial position. Specifically:*

- *liquidity is now a major concern, with the Council not maintaining a sufficient level of cash to safeguard against unexpected events*
- *Council is pre-occupied with the construction of new facilities at the expense of maintaining existing assets*
- *Council is not adequately managing its infrastructure assets and is therefore not sustainable in the longer-term.*

To assess the validity of these claims, we:

- reviewed the financial position of Council over the past 4 years and the available financial projections
- undertook a benchmarking exercise, using key financial indicators to compare the Council with other regional councils in Victoria
- reviewed the Council's management of its drainage infrastructure.

Indicators of financial performance

In assessing the financial position of the Council, we used the financial indicators detailed below.

FIGURE 11C: INDICATORS OF FINANCIAL PERFORMANCE 2000-01 TO 2003-04

Financial indicator	2000-01 (\$'000)	2001-02 (\$'000)	2002-03 (\$'000)	2003-04 (\$'000)
Operating result	1 172	1 281	1 907	4 418
Operating result after deducting non-recurrent grants and contributions	(2 769)	(3 598)	(5 475)	(1 160)
Net cash inflows (outflows) from operating activities	4 606	6 910	9 823	4 145
Net cash inflows (outflows) from operating activities after deducting non-recurrent grants and contributions	665	2 031	2 441	2 470
Positive (negative) working capital position	3 462	1 368	1 288	3 089
Working capital (current) ratio	1.94:1	1.34:1	1.25:1	1.56:1

In each of the 4 years, Council has achieved a favourable operating result and has maintained a positive cash flow position. These positive results are largely due to the receipt of capital grants and contributions. Excluding these items from the operating result shows an overall "underlying" operating deficit in each of the past 4 years. These figures indicate that Council is not generating sufficient recurrent revenue to cover its costs of operations.

The Council's 2003-04 financial result, after deducting non-recurring grants and contributions, shows a substantial improvement over 2002-03. Financial projections to the year 2008 also predict a progressively improving operating result and funding position.

A working capital ratio in excess of 1 to 1 is regarded as generally satisfactory. The average ratio for all Victorian councils in 2002-03 was 2 to 1. The ratio for the Warrnambool City Council over the past 4 years has been below the industry average, however, still above what may be regarded as adequate.

Conclusion

As indicated earlier in this report, the Council's decision to undertake a number of large capital projects in a relatively short period of time, together with delays in obtaining loan funding and the AquaZone payout, created a cash flow problem for the Council in the years 2002 to 2004.

While the Council's positive operating results and cash flow position for this period indicate a viable Council, these results are mainly due to Council's ability to attract substantial capital grants over the last 4 years. The strong "net cash flows from operations" is also to a large degree due to these capital grants.

While the Council's medium term financial projections show improving results, the Council will need to diligently monitor its operating expenditures over future years to ensure its operations remain sustainable.

Long-term sustainability

For council operations to be financially sustainable over the longer-term, council must meet its current operating costs from current revenue sources and adequately maintain the asset base to ensure there is no deterioration in operating capability. The operating capability of a council is dependent on generating sufficient revenue to fund current programs and services and to maintain its asset base.

In order to assess the sustainability of Council operations, we used 8 indicators to compare Council's performance against the average of 10 other regional councils in Victoria. The results of our assessment of the first 6 of these indicators are presented in Figure 11D.

The results indicate that:

- rates and charges revenue over the last 4 years are in line with the average of other regional councils, although higher for residential assessments
- the operating result per assessment was only half that of the regional average in 2001-02, but comparable to the average by 2002-03. However, in 2003-04 the result was again significantly below the regional average
- over the last 4 years, operating expenditure has been consistently higher than the average of other regional cities, ranging from 17 to 24 per cent over the period
- liabilities increased markedly in 2001-02 and 2002-03 and were significantly above the regional average and rising. In 2003-04, this trend reversed to be more in line with the regional average. At 30 June 2004, the Council had borrowings of \$7.8 million and an annual interest cost of around \$500 000
- capital expenditure has been consistently above the average for other regional councils, more than double in 2000-01, reducing to 44 per cent above the average in 2002-03. However, in 2003-04 (the year the Council experienced liquidity problems), capital expenditure reduced significantly.

FIGURE 11D: SUSTAINABILITY INDICATORS FOR 2000-01 TO 2003-04

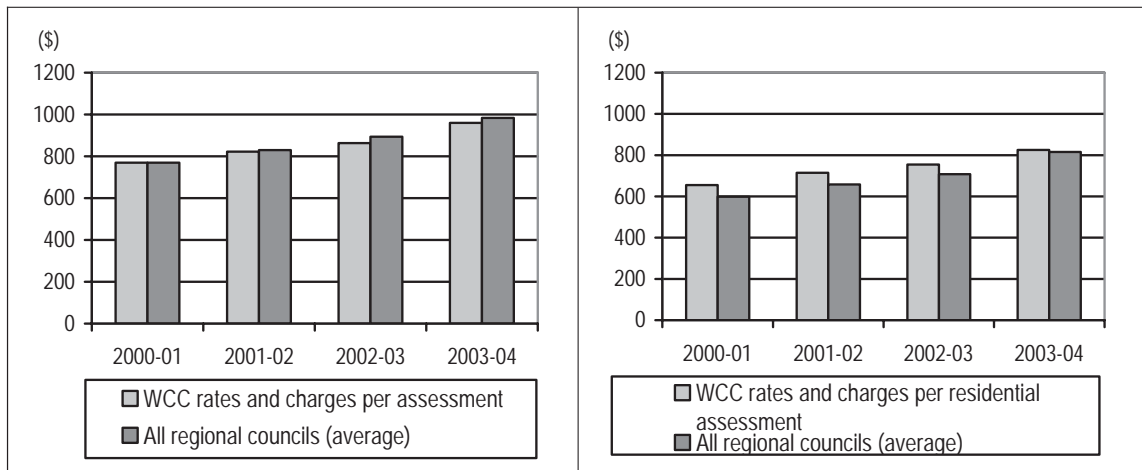
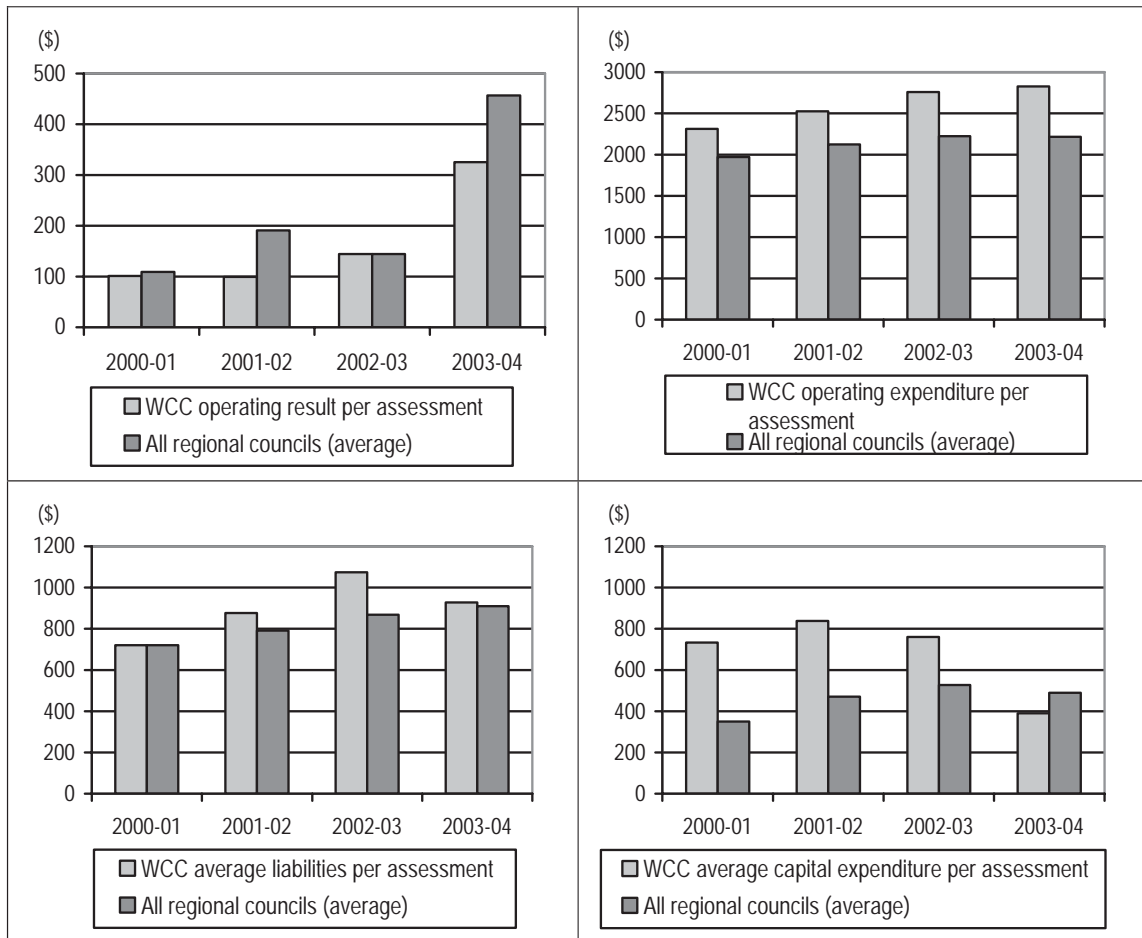


FIGURE 11D: SUSTAINABILITY INDICATORS FOR 2000-01 TO 2003-04 - continued



We also note that the Council’s financial projections to the year 2008 predict a progressively improving operating result and funding position.

A major challenge for any council is to successfully maintain the service capacity of infrastructure assets such as roads, pathways and drainage systems, which characteristically have long lives. Councils need to ensure that these assets are adequately maintained and that sufficient funds are available to replace them when the need arises.

For infrastructure assets to be sustainably managed, it is important to first assess their condition and then calculate the future maintenance renewal costs required to maintain them over their useful lives. Once the amount of expenditure required to maintain the asset is determined, the basis on which the expenditure will be funded can be identified.

In local government, 2 ratios are used to assess the management of infrastructure assets:

- ***The renewal ratio*** - is the ratio of current spending on the renewal of existing assets, which returns the service potential or the life of the assets to that which it had originally, to the long term Average Annual Asset Consumption (AAAC). The AAAC is the amount of a local government's asset base consumed during the year, based on the current replacement cost (cost or fair value), divided by the useful life and totalled for each and every infrastructure asset.
- ***The renewal and maintenance ratio*** - is the ratio of current spending on renewal of existing assets which returns the service potential or the life of the asset to that which it had originally plus maintenance, to the AAAC plus maintenance (i.e. the expected level of maintenance which was used in the calculation of the useful life of the asset).

Our review of the Council's renewal ratios over the last 4 years and against 10 other regional councils showed that:

- the Council's renewal gap at 30 June 2004 was 63 per cent compared to the regional average of 54.5 per cent. The ratio has varied between 44 per cent (2002-03) and 77 per cent (2001-02) over the last 4 years
- the renewal and maintenance gap at 30 June 2004 was 75 per cent compared to the regional average of 81 per cent. The ratio has varied between 58 per cent (2002-03) and 82 per cent (2001-02) over the last 4 years
- both ratios are significantly below the 100 per cent required to indicate that the Council is maintaining the operating capability of its asset base.

Conclusion

Around 35 per cent of total Council revenue comes from grants and contributions, 30 per cent from rates, 22 per cent from charges and 13 per cent from other sources. The level of rate revenue is consistent with the average for other Victorian regional councils, while charges are slightly higher than the average.

However, with operating expenditure and capital expenditure running higher than the average of other regional cities, the Council has relied on non-recurring grants and borrowings to pay for these expenditures. While this situation is sustainable in the short-term, continuing this practice (without additional revenues) for any extended period of time will create financial difficulties for the Council, if the current level of grant funding received does not continue.

Council's performance in asset management as measured by the asset renewal gap ratio and the renewal maintenance ratio is consistent with the average for Victorian local governments. However, with the Council reinvesting significantly less than the 100 per cent required for it to maintain the service potential of its asset base, it is not sustainably managing its non-current assets.

Management of drainage infrastructure

In early 2004, Council identified that it needed to spend \$23 million to address problems with its existing drainage infrastructure and provide new infrastructure for its expanding population. This equates to a once off cost of around \$1 660 per rateable property.

The Council is currently investigating how drainage repair, replacement and upgrading of infrastructure assets will be funded.

Conclusion

We acknowledge the work undertaken by the Council to determine the condition of its drainage assets and estimate the cost of remedial works required to meet the needs of the Warrnambool community. We also understand that due to funding constraints, it will not be possible to undertake all of these works in the short-term.

However, the current condition of the system and the significant capital investment required to return it to an adequate state, suggests that this is an area where the Council has not placed sufficient attention in the past.

Recommendation

9. That the Council:

- **continues to closely monitor its operating and cash flow positions over a rolling forward 5 year period, to ensure that its operations remain sustainable and sufficient cash is available to meet financial obligations**
- **develops an asset renewal funding strategy for the replacement of its assets**
- **develops a plan to determine how required drainage works identified in the Council's drainage strategy will be financed**
- **reviews the condition of other major infrastructure assets, to identify required capital works and develop funding strategies.**

RESPONSE provided by Chief Executive, Warrnambool City Council

The actual allegation contains 3 components being:

- (i) *That “liquidity is now a major concern”.*

Council’s 2004-05 Strategic Resource Plan is based on maintaining a working capital ratio of at least 1.5:1. Council notes from the review that “A working capital ratio in excess of 1:1 is regarded as generally satisfactory”.

Council notes that the allegation is not substantiated.

- (ii) *That “Council is pre-occupied with the construction of new assets at the expense of maintaining existing assets”.*

Between 2000 and 2003 Council undertook a major asset renewal and upgrading program. The works included replacing the 100 year old Hopkins River Bridge (\$3.5 million), replacing an outdated indoor sports stadium (\$3.1 million), capping a former landfill site (\$1.5 million), new/renewal works at the Aquazone centre (\$6.5 million) and new/renewal works at Flagstaff Hill (\$5.4 million). Clearly, these major works were a combination of new and renewal works.

- (iii) *That “Council is not adequately managing its infrastructure assets and is therefore not sustainable in the long term”.*

Council notes from the review that “Council’s performance in asset management as measured by the asset renewal gap ratio and the asset renewal maintenance ratio is consistent with the average for Victorian local governments.”

Council is aware of the asset maintenance challenge facing all levels of government, has increased its expenditure on asset maintenance and is developing strategies to further address asset management issues.

Council has completed a road management plan, undertaken a City-wide drainage strategy, and is currently reviewing its longer-term building infrastructure renewal needs. In addition the Strategic Resource Plan has been established on the basis of progressively strengthening Council’s financial sustainability.

Council is already progressively implementing matters set out in these recommendations.

11.12 Other allegations investigated

In addition to the allegations previously covered in this report, the whistleblower also made the following 3 allegations, which were investigated as part of our audit:

- Council staff did not understand the GST requirements and regularly failed to include GST on invoices. As a result, GST owing to the Commonwealth Government on transactions was not always determined and collected
- The Council knowingly released inaccurate financial information to the public, by advising the local newspaper that the Hopkins River Sports Club owed Council approximately \$30 000 in rental arrears, whereas the actual amount owed was \$64 000
- In the mid-1990s, as part of a local government reform program, the Council was required by the government to achieve savings of around \$850 000 over a 3-year period, mostly from a reduction in rates. Although the Council indicated to the government that it had achieved the rate reduction, it had not.

Our investigation disclosed no evidence to support these allegations, accordingly no further comment is made in this report.

RESPONSE provided by Chief Executive, Warrnambool City Council

Council notes that the following further allegations have been found to be not substantiated or wrong.

- *Administration of GST*
 - *Hopkins River Sports Club*
 - *Rate reductions in the mid 1990's.*
-

Auditor-General's Reports

2004-05

Report title	Date issued
Results of special reviews and other studies	August 2004
Measuring the success of the Our Forests, Our Future policy	October 2004
Report of the Auditor-General on the Finances of the State of Victoria, 2003-04	November 2004
Results of 30 June 2004 financial statement and other audits	December 2004
Meeting our future Victorian Public Service workforce needs	December 2004
Managing school attendance	December 2004
Regulating operational rail safety (2005:1)	February 2005
Managing patient safety in public hospitals (2005:2)	March 2005
Management of occupational health and safety in local government (2005:3)	April 2005

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