

VICTORIA

Victorian
Auditor-General

Planning for Water Infrastructure in Victoria

Ordered to be printed

VICTORIAN
GOVERNMENT PRINTER
April 2008

ISBN 1 921969 60 3

VAGO

Victorian Auditor-General's Office
Auditing in the Public Interest

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Legislative Council
Parliament House
Melbourne

The Hon. Jenny Lindell MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report on
Planning for Water Infrastructure in Victoria.

Yours faithfully



DDR PEARSON
Auditor-General

9 April 2008

Foreword

The water supply challenges facing Victoria, and the importance of efforts to meet them, have never been greater than they are today. This is why selecting and prioritising water supply projects to meet these challenges effectively, efficiently and economically are of fundamental importance.

The white paper, *Securing Our Water Future Together*, set out a sound framework for the sustainable management of water resources across the State. This framework was successfully applied to deliver a sustainable water strategy for the Central Region of Victoria.

However, the unprecedented low inflows of 2006 required immediate and additional actions. To address this situation a \$4.9 billion infrastructure plan was quickly developed over a six-month period. Given the speed of the response, it is not surprising that the processes used to respond to this emergency fell short of those used to form the white paper and the Central Region strategy.

A consequence however was that the rigour used to estimate the costs, benefits and risks of projects in the plan varied considerably. For some key projects, the rigour was inadequate. This should have been explained to the community at the time and a program to address these deficiencies should have been initiated. This was not done.

This report recommends that the community be apprised of the processes used to select and prioritise water supply projects. Further, it needs to be set out how the project estimates underpinning the water infrastructure plan will be verified and how this more rigorous information will be made available to the community.

Another water supply challenge emerging is the decision to deliver a desalination plant through a Public Private Partnership and to expand the water grid to augment Melbourne's water supply. This amounts to a 'whole new ballgame'. Decisive action is required to develop governance arrangements to successfully integrate these new and substantial sources with the existing water sources.



DDR PEARSON
Auditor-General

9 April 2008

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1 Executive summary

1.1 Background, scope and objectives

Victoria's prosperity and attractiveness as a place to live, work and do business depend on a secure water supply for residents, businesses, farms and the environment. In November 2007, following ten years of drought, Victoria's water storages were filled to only 26.6 per cent capacity, causing water restrictions across most of the State.

A secure, reliable supply of water requires the selection, prioritisation and delivery of infrastructure in a cost-effective and timely fashion. It is critical that water infrastructure planning processes, and the associated governance and funding arrangements, lead to the identification and delivery of effective, economical and efficient solutions.

The Department of Sustainability and Environment is Victoria's principal water planning and policy agency. The Department advises the Minister for Water on state-wide water policy, strategic, whole-of-state and regional water planning and the performance of Victoria's water authorities.

The white paper, *Securing Our Water Future Together*, committed the State Government to developing sustainable water strategies for the five Victorian water regions. These strategies will tailor the white paper's principles and actions to the characteristics and challenges facing each region. To date, the Department has completed the sustainable water strategy for the Central Region of Victoria (in October 2006).

The lowest recorded inflows to our water storages in 2006 led to the rapid development of the \$4.9 billion *Our Water Our Future—The Next Stage of the Government's Water Plan* in June 2007 (we refer to this as the 'Victorian water plan'). This included the acceleration of major water augmentation projects that had been flagged as longer term prospects in the Central Region strategy.

The present audit assessed how well the Department selected, prioritised and monitored state-wide and regional water infrastructure projects. To address this objective, we examined the adequacy of:

- the processes used to select and prioritise water supply strategies
- the processes used to monitor the progress and impacts of strategies
- the institutional and governance arrangements supporting the selection of water infrastructure projects and the development of water sector strategies
- the administration of associated funding arrangements.

1.2 Conclusions

The white paper, *Securing Our Water Future Together*, set out a comprehensive framework for the sustainable management of water resources in line with clear policy goals and within a legislated process. The Department effectively applied the white paper's planning framework to deliver the sustainable water strategy for the Central Region of Victoria.

Our review of the Department's records shows that most of the actions within this strategy have been progressed. Some, however, have fallen behind schedule as resources have been diverted to address the demands of a worsening drought.

While the white paper and the Central Region strategy have been viewed positively by stakeholders in the sector, the level of information provided to the community on water supply projects has been inadequate and needs to be improved.

While the audit recorded a favourable conclusion about the development of the white paper and the Central Region strategy, the same is not the case in relation to the recent Victorian water plan.

Audit recognises that the Department had to complete the plan as an emergency response to the record low inflows of 2006, and the risk that water supplies might run critically low within a few years. The timelines for finalising the plan were extremely tight and this explains the need to streamline the normal project development processes.

Nevertheless the processes used to develop the Victorian water plan fell short of the standard the Department applied when developing the white paper and the Central Region strategy. In particular, the plan was finalised with:

- minimal stakeholder consultation
- inadequate levels of rigour applied to estimate the costs, benefits and risks of some of the key component projects.

It is incumbent on the Government to provide full, accurate and timely information on its financial commitments and projects put before the community. The Victorian water plan did not provide this information. There were widely varying levels of rigour around the plan's costs and expected water savings benefits. The documentation did not explain this. This is essential information, especially when an emergency situation requires streamlined processes.

The Department should address these issues by clearly setting out the processes it is pursuing to verify project estimates and by publishing more rigorous information as it becomes available. Where necessity forces the Department to skip project steps or to publish figures and estimates of varying reliability, the Department should inform the community.

The audit also considered whether the institutional and funding arrangements in the water sector supported the appropriate planning of water infrastructure. We concluded that:

- the institutional arrangements are not a barrier to the appropriate selection and prioritisation of water infrastructure projects
- the funding arrangements provide the flexibility required to respond to changes affecting the achievement of the State Government's policy goals.

1.3 Recommendations

DSE should:

- 1.1 revise the Central Region strategy to account for the changed assumptions and the infrastructure commitments within the Victorian water plan
- 1.2 progressively inform the community about the costs and benefits of projects included in the Victorian water plan as this information is verified
- 1.3 publish the detailed analysis underpinning the estimates of water savings and costs for the food bowl modernisation project
- 1.4 work with the central agencies and the relevant portfolio minister to explain to the community the level of rigour underpinning project costs and benefits when publishing information on committed projects
- 1.5 implement its proposals to improve how it tracks and reports on the Central Region strategy actions
- 1.6 provide regular, consolidated reports on progress against the actions and outcomes within the white paper and the sustainable water strategies
- 1.7 publish information on the progress and impact of projects funded by the Victorian Water Trust (VWT)
- 1.8 validate the flow compliance information provided by Catchment Management Authorities (CMAs) and make the CMAs' operating and compliance reports available to the community
- 1.9 regularly make available, to the community, information about how well the Department has met its environmental flow obligations
- 1.10 strengthen the processes it uses to review water authority plans to verify they conform with Government policy objectives and that their projects and initiatives meet value for money criteria.

RESPONSE provided by Secretary, Department of Sustainability and Environment

I have a number of significant differences with the report, which I would like formally registered.

First, as you and I discussed a number of times, I do not believe that the real-time tracking of project development and implementation that the Audit Office has undertaken in this report is an appropriate or accurate means of assessing the development of water industry planning.

An audit normally occurs based on a record of what has happened and an explanation of that as it relates to outcomes. A review of a live process provides at best a snapshot of what has been done and what remains to be done, well prior to any outcomes, yet here has been presented in the same manner as if a completed process with internally established deadlines (rather than externally generated ones) was involved.

In this case, while your Office sought initially to audit a process — the 2004 White Paper and the Central Region Sustainable Water Strategy (CRSWS) 2006 — it moved from that task into the review of a live process, including a commercial tender development. The Audit Office has sought to compare that urgent and immediate response scenario with a normal policy development process. It is unsurprising but also unreasonable that it found one to be less detailed than the other.

FURTHER comment by the Auditor-General

The focus of this audit, as stated in the specification, was to assess the adequacy of planning to select and prioritise water infrastructure initiatives. The audit conduct started in late August 2007. The Government had published the \$4.9 billion Victorian water plan in June 2007.

The audit included an examination of the processes followed to select and prioritise the infrastructure projects included in the Victorian water plan. This was entirely within the scope of the audit and is an area of significant community and Parliamentary interest.

The audit stopped short of reaching conclusions about the ongoing project implementation and procurement processes. For example, on the desalination procurement process the report states in section 3.4.9 that, 'Judgement on the procurement process will have to wait until this work is completed.'

RESPONSE provided by Secretary, Department of Sustainability and Environment - continued

Second, I am disappointed that the report chooses not to note the existence of the Whole of Victorian Government Inter-Departmental Committee (IDC) which sat through-out this emergency response. This IDC functioned at Secretary level, a more senior level of representation than the similar IDC noted with satisfaction by the report when it turns its attention to the White Paper and CRSWS.

The Secretaries Water Plan Interdepartmental Committee (the Water Plan IDC) was chaired by the Secretary of the Department of Premier and Cabinet. The Water Plan IDC's membership included the Secretaries of the Departments of Premier and Cabinet, Treasury and Finance, Sustainability and Environment, Primary Industries, and the head of Regional Development Victoria. This Water Plan IDC met eight times and reported directly to the Government.

However, the proposed report continues to refer to the Victorian Water Plan being prepared by this Department, as if in isolation from the rest of Government.

FURTHER comment by the Auditor-General

The assertion that the report chose not to note the existence of the inter-departmental committee (IDC) is factually incorrect.

In its written comments on the preliminary draft report, the Department requested that the 'At a glance' section in part 3 of the report acknowledge the role of the IDC.

The fourth bullet point under the key findings section on page 21 of the report was amended to read: '**After issuing the strategy in October 2006, the collapse of water inflows led the Department of Sustainability and Environment to develop the Victorian water plan under the guidance of an inter-departmental committee.**'

RESPONSE provided by Secretary, Department of Sustainability and Environment - continued

Third, the proposed report compares different estimates of water losses in the Goulburn Murray Irrigation District (GMID) and finds them, unsurprisingly, different. Moreover, it draws an inaccurate conclusion from emphasising that one is lower than the other.

The potential losses identified in the Food Bowl Steering Committee's final report (pp 45-47) are a qualitative estimate based on rounded figures for long term deliveries and system efficiencies. The estimate is also based on the entire GMID.

The losses identified in the Early Works Business Case are different as they are:

- estimates for the GMID less the Shepparton Irrigation Area and the Central Goulburn 1-4 Irrigation Area; and

- based on quantitative modelling and are less rounded; and
- the average recorded delivery losses from the years 2004/05 and 2005/06.

In essence, the losses identified are derived from different methods and the parameters are different and cannot be compared.

FURTHER comment by the Auditor-General

When comparing the methods used to determine water losses and savings, we stated in the preliminary draft report that: ‘the estimated water losses were more refined and lower than those published in the food bowl steering committee’s final report in November 2007’.

A major concern, repeatedly noted in the stakeholder submissions to the food bowl steering committee, was the use of long-term inflows as the basis for estimating water losses and savings. Stakeholders were concerned that this assumption did not take account of climate change or the lower recorded inflows of the past decade. The final report of the food bowl steering committee did not address this concern.

The unpublished early works business case adopted a more conservative approach estimating water losses and savings based on the records for two recent years for a subset of the Goulburn Murray irrigation district.

The application of this more conservative approach will result in a lower estimate of water losses than the method used by the steering committee when applied to the same area.

The Department made no comment on this throughout its review of the preliminary draft report. Unsurprisingly, the text was retained. The Department raised this as an issue the day before the Secretary’s response to the proposed report was due.

RESPONSE provided by Secretary, Department of Sustainability and Environment - continued

We have shown your officers the analysis reviewed by those who have water entitlements at risk in this process, and their acceptance that the savings are clearly available—indeed, there was debate primarily about excess savings—but the logical conclusion to be drawn from this does not feature in your report.

FURTHER comment by the Auditor-General

The Department claimed in December 2007 that the Victorian Farmers Federation (VFF) now supported the project and accepted the validity of the water savings estimates included in the food bowl steering committee’s draft report. The Department cited a VFF media release dated 19 December 2007 as evidence of these claims.

The audit team reviewed this material and contacted the VFF. The VFF has repeatedly insisted that an independent audit of the water savings projections should be conducted. It restated this in its media release of 19 December 2007.

RESPONSE provided by Secretary, Department of Sustainability and Environment - continued

Finally, in relation to the proposed report's recommendation relating to providing regular reports on the Sustainable Water Strategies (Recommendation 1.6, p3), and the associated text in Section 4.4.1 (pp 45-47), the Department advises that it is not sensible to publish updates on a plan which in significant areas was in the process of being overtaken by events. With the publication of the Victorian Water Plan in June 2007, the reality of 2006-07 trumped the best efforts of widely consulted experts working on the CRSWS in 2005-06. The Victorian Water Plan was thoroughly outlined in the 2006-07 Annual Report.

The fact, too, that the spreadsheet of 129 actions from the CRSWS your officers reviewed was not complete is also as much a commentary on the weaknesses inherent in attempting to audit in real time during a time of shifting policy and circumstances—as noted above.

FURTHER comment by the Auditor-General

Section 4.4.1 of the report describes how the Department has recognised the need to improve how it tracks and reports on the progress of the Central Region strategy. The Department made no comment on this text in the preliminary draft report. Unsurprisingly, the text was retained.

RESPONSE provided by Secretary, Department of Sustainability and Environment - continued

I also note for the record that the CRSWS was released in the second quarter of 2006-07 (October 2006) and thus had been out for implementation for a mere six months, a six month period dominated in reality by the urgent need for a new plan in crucial areas. As such, we find the comments on the Department's Annual Report unbalanced.

FURTHER comment by the Auditor-General

The audit report compared the information provided in the Department's 2006-07 annual report, dated October 2007, with the Department's legislated reporting obligations. Until this response above, the Department had not provided this Office or the readers of the annual report with an explanation why the information provided did not meet these obligations.

2 Water planning in Victoria

2.1 The water supply challenges facing Victoria

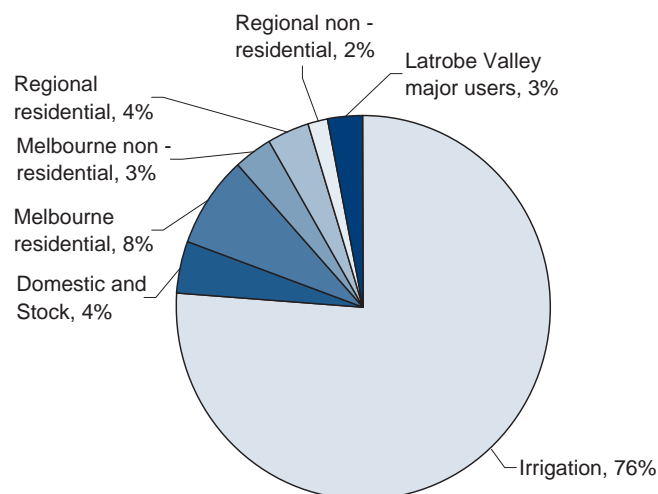
Victoria's prosperity and attractiveness as a place to live, work and do business depend on a secure water supply for residents, businesses, farms and the environment.

2.1.1 Water use in Victoria

In 2005/06 Victorian residents, industry and agriculture used nearly 4 000 billion litres of water.¹ A billion litres of water is one gigalitre.

Figure 2A shows how this water was used in 2005/06. Irrigators consumed 76 per cent of this total with a further 4 per cent used for domestic and livestock purposes by rural properties. Melbourne's residents and businesses consumed 11 per cent of the total, with regional towns and businesses accounting for a further 6 per cent. The brown coal power generators in the Latrobe Valley consumed a further 3 per cent of the total.

Figure 2A
Water use in Victoria 2005/06



Source: Department of Sustainability and Environment.

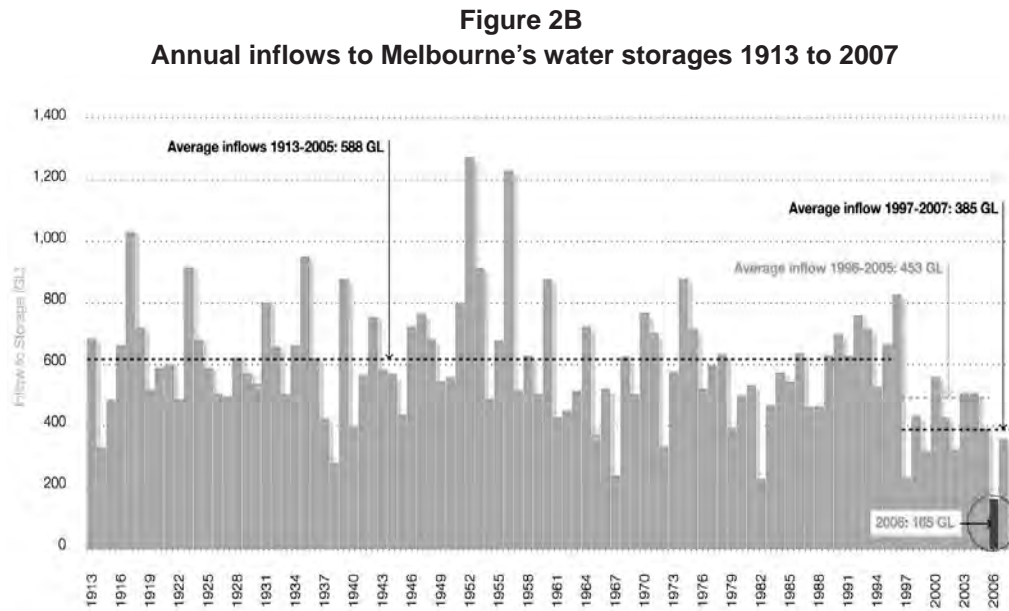
¹ Department of Sustainability and Environment 2007, *State Water Report 2005/06*, Department of Sustainability and Environment, Melbourne, Table 2-3, p.21.

Over the last seven years the Government has placed a greater emphasis on water conservation and recycling to protect and sustain Victoria's water supplies. For example, in Melbourne the water consumption per person has fallen from an average of 423 litres per day in the 1990s to 330 litres per day in 2005/06.

2.1.2 Water availability

Victoria has experienced drought conditions since 1997, depleting storages and threatening the security of water supply to many towns and farms across the state. In 2006, after nine years of below average rainfall, the drought intensified with the lowest ever recorded inflows into rivers and water storages.

Figure 2B below illustrates how the inflows to Melbourne's water storages have declined over the last 10 years compared with the longer term average.

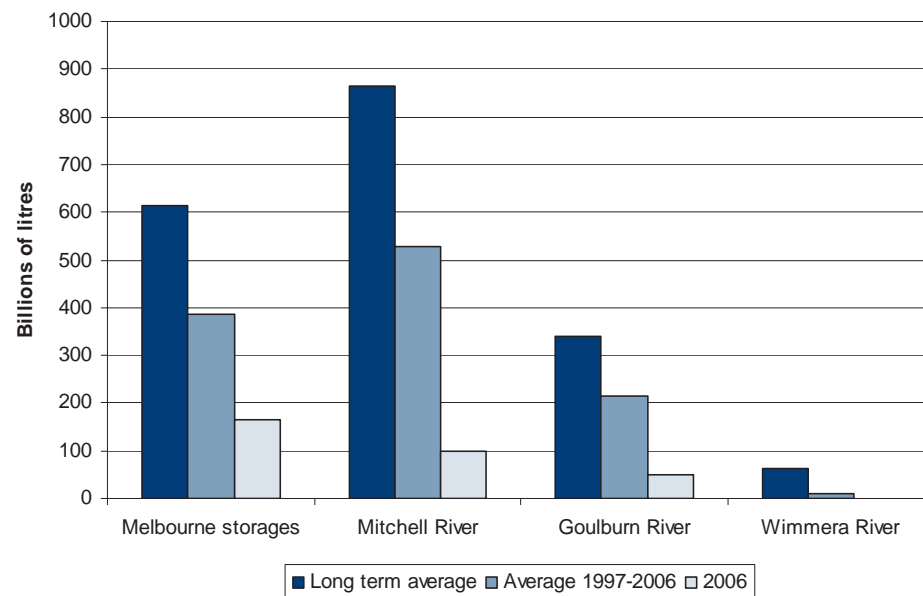


Source: Department of Sustainability and Environment

Changes in water inflows to storages and rivers

Figure 2C shows the impact of the drought on the inflows into Melbourne's water storages and for the flows past a single location on the Mitchell, Goulburn and Wimmera rivers.

Figure 2C
Comparison of average inflows



Source: State Water Report 2005/06.

In the ten years between 1997 and 2006 inflows to Victoria's major storages and rivers have been about 50 per cent of their long-term averages. In 2006 these flows collapsed to unprecedented levels. In 2007 inflows to Melbourne's storages have returned almost to the drought affected average levels of the last ten years.

This is further illustrated by changes to the total inflows into the Murray River, which fell from their long-term average of 11 000 to 5 500 billion litres per annum for the period 1997 to 2006. In 2006 inflows to the Murray fell to their lowest recorded level of 1 000 billion litres or less than 10 per cent of the long-term, annual average.

At the end of November 2007 Victoria's water storages were filled to only 26.6 per cent capacity.² Storage levels were 4 per cent lower than at the same time in 2006. The amount of water flowing through streams and rivers shows drought conditions are continuing in Victoria.

Climate change

The Intergovernmental Panel on Climate Change concluded in 2007 that there is now unequivocal evidence that the earth's climate system is warming.³ Victoria is expected to become warmer and drier, with lower but more variable rainfall.

² Department of Sustainability and Environment, *Monthly Water Report—November 2007*, Department of Sustainability and Environment, Melbourne, viewed 17 January 2008, <<http://www.dse.vic.gov.au>>.

³ Intergovernmental Panel on Climate Change, *IPCC Fourth Assessment Report*, Intergovernmental Panel on Climate Change, viewed 7 January 2008, <<http://www.ipcc.ch/>>.

The pattern of recent rainfalls and the unprecedented reduction of inflows into Victoria's major river systems and storages in 2006 mean that we may have already experienced a climate step-change. Inflows to our major water storages may settle at levels below long-term averages and be susceptible to further climate change shocks.

2.1.3 Balancing water use and water availability

The impacts of the drought on Victorians are significant and widespread. At the end of November 2007 various levels of water restrictions applied to 375 Victorian towns and cities including Melbourne.

Throughout rural Victoria, in 2007, irrigators were allocated less than 50 per cent of their allocation of high reliability water, with little prospect of any change unless there are heavy rainfalls. These allocations will affect agricultural yields, food prices and the economic output of the state.

The demands on our increasingly scarce water resources are set to increase as the Government aims to grow the economy and to accommodate a further million people in Victoria by 2025.⁴ The decade-long drought and the likelihood of an underlying climate step-change threaten the ability of our water supplies to meet current and future demands.

In this context effective long-term water planning is critical if the Government is to meet the developing needs of communities, industry, agriculture and the environment in the face of increasing uncertainty.

2.2 The Government's water policy framework

The Government set out its policy goals, intended outcomes and fundamental management principles in the white paper, *Securing Our Water Future Together*.⁵ The Government's overall goals are to provide a secure, reliable supply of water for homes, farms and industry and to provide for the environment in a way which protects the needs of future Victorians.

⁴ Department of Premier and Cabinet 2007, *Beyond Five Million—The Victorian Government's Population Policy*, Policy and Strategy Projects Branch, Department of Premier and Cabinet, Melbourne.

⁵ Department of Sustainability and Environment 2004, *Securing Our Water Future Together*, Department of Sustainability and Environment, Melbourne, p.15.

The white paper described the attainment of these goals in terms of the following sustainable outcomes:

- providing reliable and safe urban water services in-line with customer demands
- supporting a high value, low impact irrigation industry supported by robust rural and regional communities
- sustaining healthy water sources and catchments capable of delivering a wide range of water services
- building communities with a strong water conservation ethic, which appreciate all the services water provides and are able to make considered choices about the delivery of water services
- achieving increased efficiency, accountability and productive innovation within the water sector.

The white paper described the following fundamental principles for managing the state's water resources:

- understanding that a healthy economy and society is dependent on a healthy environment
- overall Government control of all water resources on behalf of Victorians
- the continued public ownership of the water authorities responsible for managing water resources and services
- users of water services, wherever practical, paying the full infrastructure, delivery and environmental costs associated with these services.

The white paper recognised the need to adequately provide water for all users and for the environment. However, it also acknowledged that providing for the basic needs of people, industry and agriculture in a time of water shortages would take priority over the full achievement of environmental flows.⁶

These goals, outcomes and fundamental principles continue to guide the Government's decisions about the provision of water in Victoria.

2.3 Victoria's approach to water planning

2.3.1 Roles and responsibilities

Department of Sustainability and Environment (the Department)

The Minister for Water is responsible for the management of water resources in Victoria and the Department is responsible for advising the Minister on:

- water policy
- strategic, whole-of-state and regional water planning
- the obligations applied to the 20 water authorities responsible for harvesting and supplying water
- the performance of these water authorities in discharging their obligations.

⁶ Ibid., p.64.

The Minister for Environment and Climate Change is responsible for setting up a framework for the integrated management and protection of catchments feeding rivers, streams and water storages. The Department is responsible for advising the Minister on:

- planning for the management of these catchments
- the use of environmental entitlements where a volume of water is legally allocated to the Minister to safeguard the health of the environment
- the obligations applied to the ten Catchment Management Authorities (CMAs) responsible for formulating regional plans to protect and sustain water resources
- the performance of the CMAs in discharging their obligations.

Department of Treasury and Finance

The Treasurer is responsible for ensuring the financial success and viability of water authorities. Jointly with the Minister for Water, the Treasurer has responsibilities for corporate planning, performance monitoring and board appointments in the metropolitan water sector.

Water authorities

Water authorities are responsible for providing water services and planning for future provision within their defined areas of operation. They have two types of corporate form:

- the metropolitan water retailers are statutory corporations limited by shares under the *Corporations Act 2001*. The directors of the boards are appointed by the Treasurer (who is the sole shareholder) and are not subject to ministerial direction
- Melbourne Water and the other regional and rural water authorities are statutory authorities, fully owned by the Victorian Government, and established under the *Water Act 1989*. The boards are appointed by the Minister for Water and are subject to the Minister's written direction.

The main difference between these two forms is the greater focus on commercial objectives for the metropolitan water retailers. While the retailers are not subject to ministerial direction the plans of all water authorities must conform to *Statements of Obligations* issued by the Minister for Water in consultation with the Treasurer.

The actions within the water authorities' plans are mostly funded through customer charges set through a regulatory process overseen by the Essential Services Commission (ESC). In some cases Government has contributed funding to programs and projects to: encourage innovative approaches and behavioural change; to deliver water savings for environmental use, and complete projects where it is impractical for local users to bear the full cost.

Catchment Management Authorities (CMAs)

The CMAs are responsible for the health of our rivers and water storages through the management of the catchments which feed and replenish these water sources. CMAs are required to:

- implement a regional catchment strategy in response to *Statements of Obligations* issued by the Minister for Environment and Climate Change
- plan the longer term and day-to-day use of water set aside for the environment (through a three to five-year environmental operating strategy and an annual watering plan)
- report on compliance with these strategies and plans to the Minister for Environment and Climate Change.

Their activities are funded through State and Federal Government grants.

Regulators and inquiries

The following agencies have regulatory responsibilities:

- the Essential Services Commission (ESC) regulates prices
- the Environment Protection Authority Victoria (EPA) is responsible for protecting the environment
- the Department of Human Services (DHS) regulates drinking water quality
- the Energy and Water Ombudsman deals with water authorities' customer complaints.

The Victorian Competition and Efficiency Commission (VCEC) *Inquiry into Reform of the Metropolitan Retail Water Sector* was published as a draft report in December 2007.⁷ The final report was delivered on 29 February 2008 and will be published once the Government has formulated its response.

The focus of the inquiry is to find ways to restrict price increases, while maintaining service reliability and quality. The draft report raised some issues of relevance to this audit in relation to water supply planning and governance.

Victorian Water Trust (VWT)

The Government established the VWT in April 2003 as a \$320 million fund to provide a stable, long-term source of investment in Victoria's water resources. The Government appointed a Chair and a further three members to form an advisory council in the middle of 2003.

⁷ Victorian Competition and Efficiency Commission 2007, *Water Ways: Inquiry into Reform of the Metropolitan Retail Water Sector*, draft report, Victorian Competition and Efficiency Commission, Melbourne.

The purpose of the VWT⁸ is to fund, at the final direction of the Minister for Water, programs that will deliver on the following targets:

- increasing the efficiency of irrigation systems by 25 per cent by 2020
- reducing Melbourne's drinking water use by 15 per cent by 2010
- significantly improving the ecological health of Victoria's rivers by 2010
- recycling 20 per cent of Melbourne's wastewater by 2010.

The role of the council is set out in Section 305CC of the *Water Act 2003*:

- advising the Minister on the allocation of funds for initiatives that:
 - enhance the health and sustainability of the water resources of Victoria, including rivers
 - provide greater security to meet the future water needs of Victorians
 - encourage the increased re-use and recycling of water in Victoria
 - improve efficiencies in the use of water across Victoria.
- advising the Minister on additional sources of funding for initiatives
- providing information to the public on procedures for applying for funding for initiatives
- promoting public awareness of the activities of the council
- advising the Minister on any other matter that the Minister may request.

The VWT advisory council provides advice to the Minister in line with its defined role. It has no powers to approve projects or to allocate funding for their completion. These responsibilities remain with the Minister for Water.

The \$320 million of funding committed to the Victorian Water Trust has been disbursed in three phases:

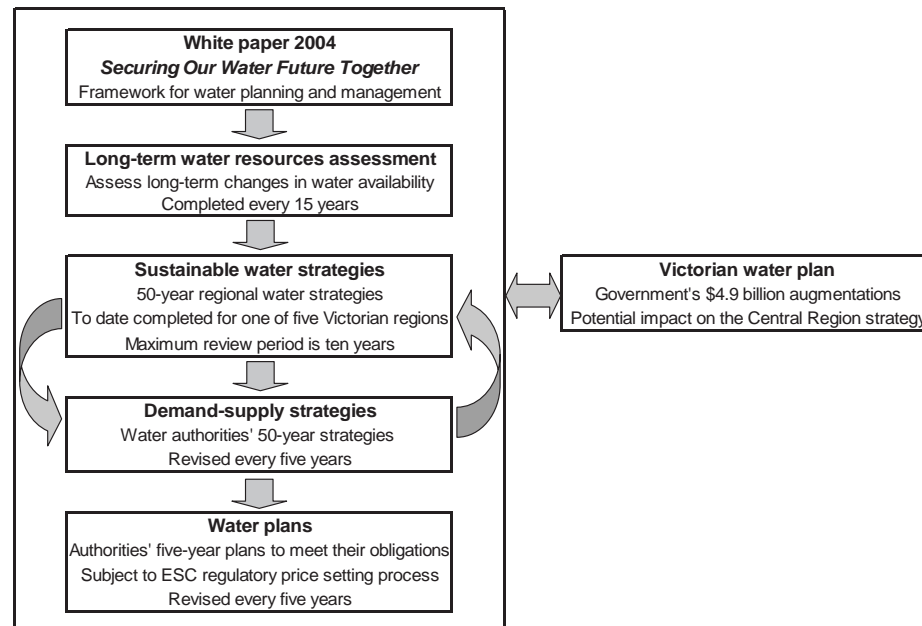
- The first phase of \$162 million funded the Government's 2002 election commitments, which preceded the formation of the VWT advisory council
- The second phase of \$108 million provided funds for projects recommended by the VWT advisory council while an additional \$4 million was allocated to the Water Smart Homes and Gardens project
- The third phase committed \$50 million to the Victorian water plan.

2.3.2 Water supply strategies, plans and reviews

Figure 2D summarises the documents and reviews used to shape water planning in Victoria including the state-wide framework and the regional and local plans.

⁸ Victorian Water Trust advisory council, *Victorian Water Trust Advisory Council Operating Guidelines*, 2003.

Figure 2D
Water strategies and plans



Source: Victorian Auditor-General's Office.

Securing Our Water Future Together (the white paper)

The white paper was published in 2004 as a whole-of-state action plan to secure water for homes, farms, businesses and the environment for the next 50 years. It described actions to address the following priority areas:

- improving the framework for allocating water resources recognising the needs of all water users and the environment and setting up a process for regional water planning and review
- restoring stressed rivers and aquifers by creating a legal water entitlement for the environment and improving the planning and management of river health
- promoting the smarter use of irrigation water by unbundling water entitlements and land ownership rights and promoting investment in new, more efficient irrigation practices
- encouraging the smarter use of urban water through a range of investment and pricing measures to increase water conservation and recycling
- making the water sector more efficient, accountable and innovative by improving the institutional governance arrangements.

Long-term water resources assessment

This assessment, completed every 15 years, determines whether:

- there has been any decline in the long-term availability of surface water or groundwater

- any decline has fallen disproportionately on the environmental water reserve or on the allocation of water for consumptive purposes
- waterway health has deteriorated for reasons related to flow.

This assessment should identify significant long-term resource changes related to climate and land-use changes.

Regional sustainable water strategies

The aim of these strategies is to provide a comprehensive, 50-year plan for the sustainable use of water resources tailored to the needs and circumstances of each of the five water regions in Victoria. The Grampians and South-West Regions have since been combined for the purpose of forming a regional strategy and there will now be four strategies covering Victoria. The strategies were intended to apply the white paper's framework changes within a detailed, regional plan.

To date, the Department has completed the strategy for the Central Region of Victoria (in October 2006), encompassing the urban centres of Greater Melbourne, Geelong, Ballarat, Warragul and Traralgon.⁹ The Department has also issued a discussion paper for the Northern Region sustainable water strategy and is on track to complete this by early 2009.

The legislation requires that the strategies are reviewed at least every ten years. In addition, the Central Region strategy committed to an annual review of water availability and demand given the current low inflow conditions.

Demand-supply strategies

Water authorities are responsible for forming these strategies to show how they will balance water demand and supply over a 50-year period. These are framed by the white paper's policy direction and principles and are essential inputs to the sustainable water strategies.

In some cases, where there are clear dependencies and overlaps, authorities have produced a combined demand-supply strategy. This is the case for Melbourne, where Melbourne Water and the three water retailers combined to document a single strategy.

Water authorities must update these strategies every five years before finalising their water plans.

⁹ Department of Sustainability and Environment 2006, *Central Region Sustainable Water Strategy*, Department of Sustainability and Environment, Melbourne.

Water authorities' five-year water plans

Water authorities must each develop a water plan that complies with the requirements set out in the *Statements of Obligations* issued by the Minister for Water to each water authority. The water plan must describe how the authority will deliver on service standards across a five-year period, the revenue needed to do this, and the prices proposed to generate this revenue.

The Essential Services Commission (ESC) reviews these plans and must agree with the proposed prices before the plans are finalised.

The Victorian water plan

The Government issued the document *Our Water Our Future—The Next Stage of the Government's Water Plan* in June 2007 (we refer to this as the 'Victorian water plan').¹⁰ This plan was the Government's response to the unprecedented fall in the volume of inflows to water storages in Melbourne and other towns in Victoria.

This \$4.9 billion commitment accelerated the delivery of some of the Central Region strategy's water augmentation proposals and supplemented these with new projects.

2.3.3 Funding water supply strategies

Strategies and their component projects are funded by:

- water authorities' customer charges
- the Victorian Government through the VWT, or separate contributions to specific projects
- contributions from the Federal Government.

Customer charges

These are the most important source of funding. For example, nearly 90 per cent of the \$4.9 billion cost of the Victorian water plan will be funded through customer charges.

The regulatory process for setting prices over a five-year period may be summarised as follows:

- Government's requirements are set out in *Statements of Obligations* and this includes policy directions and the objectives and targets contained in Government endorsed strategies
- water authorities produce a draft water plan describing: how they will deliver on these obligations, and their proposed prices to generate the required revenues
- The Essential Services Commission (ESC) determines final water plans which meet the water authorities' obligations cost-effectively.

¹⁰ Department of Sustainability and Environment 2007, *Our Water Our Future - The Next Stage of the Government's Plan*, Department of Sustainability and Environment, Melbourne.

The Federal Government has contributed to a small number of projects, such as the Wimmera-Mallee pipeline, which are directly supported by national strategies.

2.4 Our approach to the audit

The objective of the audit is to assess how well the Department of Sustainability and Environment (the Department) selects, prioritises and monitors the implementation of state-wide and regional strategies to achieve the Government's water policy goals.

To address this objective, we examined the adequacy of:

- the processes used to select and prioritise water supply strategies
 - the processes used to monitor the implementation and impacts of water supply strategies
 - the water sector institutional and governance arrangements
 - the water infrastructure funding arrangements.
-

3 Selecting and prioritising water supply strategies

At a glance

Background

For water supply strategies to be effective they need to be based on:

- clear and consistent goals
- a thorough understanding of the context
- a reliable appraisal of the associated costs, benefits and risks.

To assess the selection and prioritisation of Victoria's water supply strategies, we examined the state-wide water plan set out in the white paper, *Securing Our Water Future Together*, the Central Region sustainable water strategy and the Victorian water plan.

Key findings

- The white paper set out a satisfactory framework for the sustainable management of water resources to achieve the Government's policy goals
- The white paper was comprehensive, balanced and well supported, but did not clearly prioritise, schedule and cost the 110 planned actions.
- The Central Region strategy applied the white paper's framework for regional water planning to the Central Region of Victoria.
- After issuing the strategy in October 2006, the collapse of water inflows led the Department of Sustainability and Environment to develop the Victorian water plan under the guidance of an inter-departmental committee. The Department had to complete the plan as an emergency response within tight timeframes.
- The time constraints around the plan meant consultation was not as comprehensive as it was for the white paper and the Central Region strategy.
- The community was not told that the rigour of the cost estimates varied significantly across the plan components.
- Information provided on the food bowl project did not adequately explain the basis for the water savings estimates.
- A final business case covering the food bowl project's early works has been developed and this included additional information on the expected water savings and costs.

At a glance - *continued*

Key findings continued

- The processes used to nominate a Public Private Partnership as the preferred form of procurement for the desalination plant met the Partnerships Victoria guidelines.
- The Partnerships Victoria process requires a further value for money analysis before the preferred procurement form is confirmed in 2009.
- The Victorian Water Trust advisory council used clear and sound planning processes to recommend funding for projects valued at \$110 million.
- For the remaining funding, \$160 million funded the Government's 2002 election commitments and \$50 million has been transferred as a Government contribution to the Victorian water plan.

Key recommendations

The Department should:

- revise the Central Region strategy to account for the changed assumptions and the infrastructure commitments within the Victorian water plan
- progressively inform the community about the costs and benefits of projects included in the Victorian water plan as this information is verified
- publish the detailed analysis underpinning the estimates of water savings and costs for the food bowl project
- work with the central agencies and the relevant portfolio minister to explain to the community the level of rigour underpinning project costs and benefits when publishing information on committed projects.

3.1 Background

We assessed the adequacy of the selection and prioritisation of the components of water supply strategies by examining whether the Department had applied processes to:

- clearly define and consistently apply the overall goals of water sector planning
- form an objective and comprehensive understanding of the issues relating to these goals and the future threats to their achievement
- consider the full range of reasonable options for achieving these overall goals
- reliably measure and take account of all costs, benefits, timelines, risks and key stakeholder views relevant to the selection and prioritisation of strategies.

3.2 White paper (*Securing Our Water Future Together*)

3.2.1 The white paper set out a satisfactory framework for the sustainable management of water resources to achieve the Government's policy goals

The white paper clearly defined water supply goals and considered a wide range of measures to achieve these

To achieve the Government's goals, in the face of growing demand and more uncertain inflows to our water storages, the white paper recognised the need to include a broad range of complementary measures. The white paper recognised the need to provide for current and future water uses in a way that could be sustained without damaging the environment.

The paper considered a wide range of options to address these challenges, going beyond a traditional approach of building new infrastructure to expand supply. These options included:

- legislative changes to improve efficiency, clarify water rights and promote good planning
- actions to promote conservation and recycling
- strategies to protect the environment
- infrastructure projects to increase the supply of water.

The white paper's planning processes provided the opportunity for government agencies, specialists in the field and a wide range of stakeholders to contribute

The Department consulted widely with stakeholders and the wider community on the proposals set out in the draft (Green) paper.

The Government established an expert task force that evaluated the proposals in the green paper, taking account of the stakeholder submissions responding to this document. The Department continued to work with stakeholders in moving from the draft proposals in the green paper to the final plan set out in the white paper.

The stakeholders we consulted were positive about the planning processes used to determine the white paper's content.

The Government established inter-departmental committees at the secretary and officer levels to promote cross-departmental input to the white paper.

The white paper's planning processes led to a balanced and extensive plan supported by a wide range of stakeholders

The breadth and detail of the white paper is illustrated by the inclusion of:

- legislative changes to unbundle water and land rights to make water trading more efficient
- a structured (and legislated) approach to the state-wide allocation and monitoring of water resources, and the regional planning processes used to match water demand to the available supply
- increased water conservation through actions to raise public awareness, restructure prices, and fund specific investments
- funding for water recycling projects
- a legal water entitlement for the environment and putting in place a process to set minimum flows for major river systems in Victoria
- infrastructure projects to augment the water supply as one component of the overall approach
- a legislated planning framework for applying the paper's principles within regional sustainable water strategies.

3.2.2 The white paper was comprehensive, balanced and well supported, but did not clearly prioritise, schedule and cost the 110 planned actions

The document included more than 150 pages of text and a diverse set of 110 actions. These actions were gathered together under six major themes.

These actions ranged from commitments to major legislative and structural change to much smaller scale and specific measures such as 'encouraging the use of water efficient washing machines and dishwashers through the water efficiency labelling scheme'.¹ The white paper did not identify the most important actions.

For some of these actions, the white paper estimated costs and set timelines, but for the most part these were not included.

¹ Action 5.11.

The Department had a clear view on the most important aspects of the plan. These included the reform of the water allocation, planning and management frameworks, and encouraging water conservation and recycling.

Providing an overview of these underlying priorities and putting timelines against each action would have been useful additions to the document.

3.3 Central Region sustainable water strategy

3.3.1 The Central Region strategy applied the white paper's framework for regional water planning to the Central Region of Victoria

The goals of the strategy were clear and consistent

This strategy was the first application of the regional planning processes recommended in the white paper. The goals of the strategy were consistent with those set out in the white paper as the Government's policy.

The Department used sound processes to define the issues, formulate options and select projects for the final strategy

The strategy was informed by the extensive analysis in the water authorities' demand-supply strategies. These described the supply challenges for the next 50 years and the options for maintaining the balance between demand and supply.

In formulating the strategy the Department:

- wrote a discussion paper and included over 90 potential projects covering water conservation, recycling and augmentation
- formed a working group made up of a wide range of relevant stakeholder representatives and accepted submissions on the discussion paper options
- evaluated the options within an assessment framework taking account of the financial, economic, environmental and social impacts and likely risks
- formed an independent (expert) panel to recommend which options should be taken forward in the light of the assessments and the stakeholder submissions.

The strategy was published in October 2006 and included:

- well formulated targets and plans to increase water conservation and recycling
- specific commitments to short-term and smaller scale projects to augment the water supply
- actions to investigate larger water augmentation options for the medium-term
- commitments to safeguard and then increase environmental flows on the region's major rivers.

The strategy governance was sound and shared many similarities with the structure underpinning the development of the white paper

The strategy's approach to governance was similar to that used for the white paper:

- the Department engaged a wide range of stakeholders in moving between the draft and final strategy documents
- the Department made use of an independent panel to involve relevant expertise in the selection of projects
- an inter-departmental committee made sure there was cross departmental engagement during the planning process.

The stakeholders we consulted were positive about the planning processes used to determine the strategy.

3.3.2 After issuing the strategy in October 2006, the collapse in water inflows led the Department to develop the Victorian water plan

It was reasonable for the strategy to assume that, as a worst case, future inflows would conform to the drought affected average of the last ten years

Forecasting future inflows and choosing a worst case scenario remains a significant challenge. The possibility that global warming had led to a 'step change' to storage inflows had gained widespread acceptance. However, it was difficult to distinguish this change from the effects of the ten-year drought.

Historical patterns gave rise to the expectation that the drought would soon break. If this happened the impact of climate change would place inflows between the drought affected average of the past ten years and the higher average inflows of the past 100 years.

The final strategy planned on the basis that the average inflows of the last ten years would continue into the future.

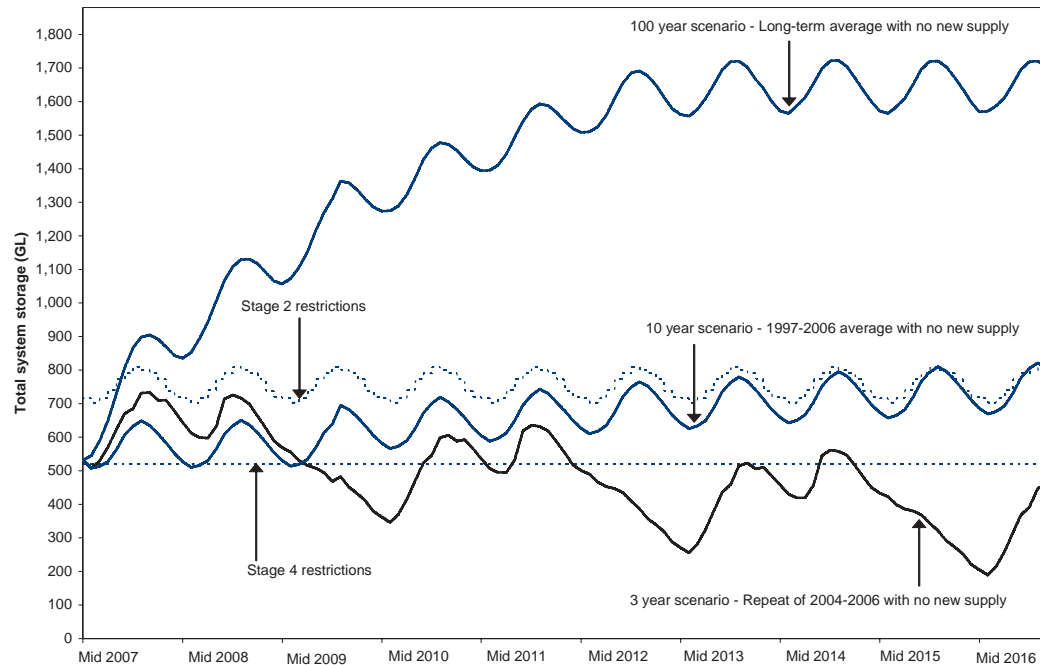
The Department considered this a reasonable worst case scenario because past drought cycles rarely went beyond a decade and this assumption allowed for a reduction in inflows to account for climate change.

By February 2007 the Department had adopted the lower average inflows between 2004 and 2006 as the basis for the Victorian water plan

By December 2006 the Department understood that the 2006 inflows to water storages had fallen well below the drought affected averages of the last decade. The spring rains usually feed through into water storages by the end of November. The Department needed to wait until the end of the year to understand the full extent of the 2006 shortfall.

The available information in early 2007 pointed to another year of very low inflows to water storages. A repeat of the 2006 pattern would lead to extreme hardship for many Victorians and the need for additional water restrictions for most of Victoria's urban populations. Figure 3A illustrates the future scenarios considered by Government.

Figure 3A
Forecast Melbourne storage levels 2007–2016 under three possible scenarios



Note: No new supply except Tarago Reservoir reconnection, November 2009.

Source: Melbourne Water.

The Government decided to commit to additional water augmentation to guard against the risk that the pattern of the last three years would be repeated (the '3 year scenario' in the diagram).

While this is not the most likely forecast, the impacts of climate change make the future more uncertain. Government considered that the scale and impact of the consequences of this worst case scenario justified the actions included in the Victorian water plan.

3.3.3 The Central Region strategy needs revision to account for the changed assumptions and the infrastructure commitments within the Victorian water plan

The adoption of inflow assumptions based on 2004 to 2006 inflows represents a significant change from the strategy assumptions. In addition, the Victorian water plan committed the Government to accelerate the introduction of major water augmentation projects affecting the Central Region.

The scale of these changes means the Department needs to revise the strategy objectives, targets and actions in the light of these changes. For example, once these augmentation projects come on line, the justification for the scale of spending on conservation and recycling needs to be revisited.

The Department has committed to an annual review of the strategy and this provides the opportunity to monitor the trends in inflows. It is not designed to fundamentally alter the strategy in the light of the changes brought about by the Victorian water plan.

3.4 Victorian water plan

3.4.1 The Department had to complete the plan as an emergency response within tight timeframes

The plan included funding of \$4.9 billion for new projects to secure water supplies for Melbourne, regional centres and some irrigators in Northern Victoria over the next five years.

In June 2006² the Government committed to the following projects:

- a 150 billion litre desalination plant and an 85km pipeline linking the plant to Melbourne (\$3.1 billion)
- the major upgrade of irrigation infrastructure in the food bowl in Northern Victoria with savings shared between irrigators, the environment and Melbourne (\$600 million contribution to a \$1 billion project)
- a 70km, Sugarloaf pipeline connecting Melbourne with the Goulburn system to access a portion of the savings from the food bowl upgrade (\$750 million)

² Office of the Premier, *Desalination and pipelines to secure water supplies*, media release, Melbourne, 19 June 2007.

- further expansion of the Victorian water grid to connect Geelong to Melbourne's supplies (\$20 million Government contribution to the \$80 million cost), and to connect Hamilton to the Wimmera-Mallee system (\$10 million Government contribution to the \$30 million cost).

The Department was required to develop the plan over a four-month period to a point where Government could decide on the plan elements and commit funding to deliver these projects. The Department started to formulate the plan in early in 2007.

The Department made use of the available information and further developed feasibility studies for the projects within the plan.

3.4.2 The time constraints around the plan meant consultation was not as comprehensive as it was for the white paper and the Central Region strategy

There was minimal consultation with stakeholders outside government before the decision to commit to the plan components

Water authorities, peak bodies and interest groups confirmed that there was little consultation over the selection of projects for inclusion in the plan. Some agencies, such as Melbourne Water, were engaged in carrying out feasibility studies for components of the plan. However, their involvement was restricted to providing information without clear feedback on how the Department used this information to determine the recommended plan.

The public submissions on the food bowl steering committee's draft report confirmed that stakeholders were concerned about the lack of consultation before committing to the project.³

The Department has put in place mechanisms to consult stakeholders as part of the detailed development and delivery of the projects in the plan

The Department has taken action to communicate the nature and benefits of the plan and to consult stakeholders and the community on the implementation of these projects.

³ Department of Sustainability and Environment, *Submissions made on the Food Bowl Modernisation Project Steering Committee's Draft Report*, Department of Sustainability and Environment, Melbourne, viewed 1 April 2008, <http://www.ourwater.vic.gov.au>.

For the food bowl project the Government formed a steering committee of relevant stakeholders to advise the Minister for Water on how the project should be implemented. The Department has engaged with stakeholders and the local community on the implementation of the desalination plant in Gippsland.

We note the dissatisfaction expressed by some members of the affected local communities and stakeholder groups about:

- the timing of the consultations, after decisions had been made by Government
- the conduct of the consultations, providing insufficient information or sufficient time to formulate an informed response.

3.4.3 The community was not told that the rigour of the cost estimates varied significantly across the plan components

The State Government has stated a commitment to sound financial management and good project development practices

In 2000 the *Financial Management Act* committed the public sector to the principles of sound financial management. This required the Government's financial policy objectives and strategies to relate to these principles.⁴

These principles include: 'that the Government must ...provide full, accurate and timely disclosure of financial information relating to the activities of the Government and its agencies'.⁵

The Government has supported the adoption of better practice models for the development and management of public sector projects. The Partnerships Victoria and Gateway units within the Department of Treasury and Finance provide guidance on the development and implementation of project proposals.

In this guidance material the purpose of a business case is to provide sufficient information so that key decision-makers are able to commit funding to a preferred option. This requires reliable information on the project costs, benefits and risks so that decision-makers can:

- be assured that the beneficial outcomes justify the expected costs
- differentiate between options on the basis of the beneficial outcomes, costs and risks to inform their choice of preferred option.

There are several developmental stages leading to the formulation of a full business case including identifying project options, completing a feasibility study and forming a concept design. The level of precision around the project costs will increase as a project proceeds through these stages with the most reliable estimate available once the business case has been completed.

⁴ Financial Management Bill, second reading, p.3.

⁵ *Financial Management Act 1994*, Section 23D.

The level of precision varied across the plan components

In June 2006 the Victorian water plan committed spending of \$4.9 billion over a five-year period to deliver additional water supply infrastructure. We examined the basis for this spending commitment. Figure 3B summarises the source of the cost estimates and the level of precision achieved.

Figure 3B
Victorian water plan cost estimates

Project	Published capital cost	Source	Comment
Desalination plant and pipe to Melbourne	\$3.1 billion	Melbourne Water feasibility study	The costs for this project were based on a business case equivalent analysis. The published capital cost was not the highest probability estimate available.
Food Bowl Upgrade	\$1 billion (first stage)	Report by the Food Bowl Alliance on Modernising the Goulburn Murray Irrigation District ⁶	High level costing based on the work of the Food Bowl Alliance stakeholder group. These high-level estimates were used in the food bowl steering committee draft report in November 2007. Several stakeholder submissions disputed the reliability of the costs and argued for more detailed costing before the project proceeded. Costs were based on a pre-feasibility study.
Sugarloaf pipeline	\$750 million	Melbourne Water feasibility study	Represents the 'P80' cost estimate. This means there is a 20 per cent chance the cost will exceed this figure. The final business case (December 2007) has confirmed this cost estimate. Costs were based on a detailed feasibility study.
Geelong–Melbourne pipeline	\$80 million	DSE estimate	The most up-to-date cost estimate is \$120 million. This costing is based on the Essential Services Commission's review of Barwon Water's costing of a detailed conceptual design. The earlier DSE estimate was based on a less detailed design. ⁷
Hamilton–Grampians pipeline	\$30 million	Wannon Water	Sourced from Wannon Water's demand-supply strategy.

Source: Victorian Auditor-General's Office.

The level of rigour applying to the components of the plan varies considerably. For example, the food bowl upgrade costs represent the lowest level of rigour and were, at that time, based on a preliminary study by a stakeholder group (the Food Bowl Alliance).

⁶ RMCG, *The Food Bowl Alliance—Modernising the Goulburn Murray Irrigation District*, final draft report, prepared for the Department of Sustainability and Environment, Victoria, 2007.

⁷ Essential Services Commission, *2008 Water Price Review Draft Decision—Volume II: Barwon Water*, Essential Services Commission, Victoria, 2008.

In contrast, the desalination plant costs were based on a significant body of technical work on the project costs and risks. However, the decision was made to publish a lower probability figure (i.e. a lower estimate) when a higher probability figure was available.

It is reasonable for the community to expect that, if a more accurate cost is available then this cost would be disclosed rather than a less accurate cost. If the less accurate estimate is published then this needs to be justified.

The development of the plan as an emergency response understandably did not allow the formulation of rigorous cost estimates for all the plan components. In some cases the level of precision, at the time the plan was announced, fell below that required within a business case. This should have been mitigated by more explanation of both the stage reached and the process being followed to fully justify strategies and plans before implementation.

In general, where necessity forces a procuring agency to publish figures of low or variable reliability, it should inform the community that it is doing this.

3.4.4 Information should have been provided on the level of cost precision, and how estimates would be confirmed

The Department should work with the central agencies and the relevant portfolio minister to explain to the community the level of rigour underpinning project costs and benefits when publishing information on committed projects.

3.4.5 Information provided on the food bowl project did not adequately explain the basis for the water savings estimates

The announcement of the food bowl project in June 2007 was not informed by a rigorous cost analysis and full validation of the water savings estimates

At that time the supporting documentation consisted of the submission by the Food Bowl Alliance advocating the project. We found this documentation did not have the depth of analysis and level of rigour commensurate with a project business case.

The Government formed the food bowl steering committee subsequent to the announcement of the Victorian water plan. The committee's terms of reference focussed on the arrangements and rules for implementing the project. The audit notes that the committee did not have a remit to verify the water savings estimates on which the project is based.

The committee published a draft report, held public meetings in early October 2007 and invited stakeholder submissions on the draft report. The committee published its final report in November 2007.

A wide range of individuals and organisations raised concerns about the basis for the projected water savings

Among the concerns expressed by stakeholders over the estimates of water savings were the following:

- The food bowl steering committee's draft report states that 'it is difficult to determine where the losses occur in the current system'.⁸ Yet summaries of projected savings are provided without the detailed assumptions used to calculate them. (*Swan Hill Rural City Council*)
- 'There is a very real danger that there may be significant inaccuracies in the figures that are leading the argument that there are substantial savings available.' (*Rochester Campaspe Irrigation Water Services Committee*)
- This submission expressed considerable uncertainty over the projected water savings because the measurement method is unclear and the assumptions about on-farm water efficiencies run contrary to the experience of many farmers in the region. (*Municipalities in the Goulburn Murray Irrigation District*)
- 'Many of the assumptions about savings in the report are incorrect which undermines the entire project... modelling the savings over the past 100 years does not accurately take account of the savings made in the past 10 years... through improved management and customer cooperation. A full audit of the claimed savings must be undertaken before this project proceeds.' (*Shepparton Water Services Committee*)
- 'The report does not explain how these figures (savings) were derived nor were they attributed to any individual or organisation. It is acknowledged (on page 27) that the technical basis for calculating and monitoring savings and losses needs to be done as part of Stage 1... this should have been done before the report was released.' (*Murrindini Shire Council*)
- 'The sources of information, assumptions and estimates underlying the calculations of losses and potential savings must be made explicit in the final report.' (*Environment Victoria*)
- 'the quantum of stated assumed losses appears to be much higher than the actual losses experienced in recent years'. 'The sole use of average long-term inflows to calculate savings is a serious concern because it does not address exceptions to the average or the potential of permanent climate change. The presumption of average long-term inflows is too simplistic for such an important decision.' (*Fruit Growers Victoria Ltd*)
- 'The assumptions underlying the calculations of losses and potential savings must be made clear in the final report.' (*University of Melbourne Office for Environmental Programs and Law School*)

⁸ Section 6.25.

- 'The report recommends annual and ongoing audits of the actual savings which is welcome, but a thorough and independent audit of the projections should be conducted' (*Victorian Farmers Federation*).

The food bowl steering committee's final report provided no new information to address stakeholder concerns about the water savings

The report added the following note to the table showing the estimated water savings: '(Note that these are estimates and are not to be used to audit savings against. Audits of savings will require measurement and comparison of pre and post project savings)'.

At the time of the commitment to the project, there was no rigorous analysis to validate the expected level of water savings. The food bowl steering committee's final report did not address this issue.

The Government response to the food bowl steering committee's final report endorsed 50 of the 52 recommendations, but made no reference to the resolution of these outstanding stakeholder concerns.⁹ The Government would not agree to applying headworks charges to water entitlements designated for the environment and would not commit to allocating half of any savings in excess of the Government's targets for irrigators.

3.4.6 A final business case covering the food bowl early works has been developed and this included additional information on the expected water savings and costs

The Department had developed a draft business case for the food bowl project by November 2007 and is working to finalise this business case by the third quarter of 2008.

In addition the Department developed a business case for the for early project works which had to be completed in the winter of 2008 to allow the remaining project elements to proceed. The business case was endorsed in December 2007 and included a more rigorous validation of the projected water savings and the costs of these early works. This included sensitivity testing the projected water savings under an alternative climate change scenario.

The Department provided us with access to the early works business, a draft version of the business case for the full project and the background documents underpinning more refined estimates of the project costs and estimated water savings.

⁹ Victorian Government, *Government's response to the Food Bowl Modernisation Steering Committee's recommendations*, Victorian Government, Melbourne, 2007.

We examined the early works business case and found that:

- the food bowl project was considered to be a high-value, high-risk project requiring careful planning, design and management
- the capital works were fitted within a pre-determined budgetary cap
- the estimated costs were based on Goulburn-Murray Water's (GMW) experience in implementing similar automation projects and an office based ('desktop') analysis of the likely infrastructure needs. At the time the business case was endorsed GMW was completing a more detailed design exercise informed by site visits and inspections
- the estimated water losses were more refined and **lower** than those published in the food bowl steering committee's final report in November 2007
- the target water savings were achievable within the allocated budget
- a cost-benefit analysis was not included. This would have provided a quantifiable estimate of the project's value for money and highlighted the likely impacts if the costs or the water savings varied from their expected values.

3.4.7 The community should be better informed about the basis for the project costs and benefits

The information in the finalised food bowl early works business case should be available to the community

In responding to an imminent threat, the Department was required to develop proposals and costings under very tight timelines. For some projects, such as the food bowl upgrade, this understanding meant the standard of rigour was less than normally expected when asking Government to commit to a project.

In line with the principle of providing timely, full and accurate information on its activities, the Department should share comprehensive information with the wider community and allow stakeholders to assess whether all relevant considerations have been addressed.

3.4.8 The processes used to nominate a Public Private Partnership as the preferred form of procurement for the desalination plant met the Partnerships Victoria guidelines

Choosing the procurement method should be informed by a good understanding of the costs, benefits and risks

Deciding on a preferred procurement route usually occurs when government considers the project business case. The decision should be informed by:

- a fully scoped and costed preferred option assuming public sector delivery
- a quantified estimate of the risks

- an assessment of the relative merits of alternative procurement forms taking account of the Government's objectives, priorities and the nature of the project.

We examined (the full report versions of) the desalination feasibility study¹⁰ and the desalination procurement analysis.¹¹ We found that these documents provided the information Government needed to nominate a preferred procurement route.

The feasibility study provided an adequate costing of a desalination plant in the preferred location and quantified the key risks of the project. The procurement analysis appraised four procurement options against criteria based on the Government's key objectives. The report also provided a detailed rationale for the relative rankings of each procurement option.

3.4.9 The Partnerships Victoria (PV) process requires a further value for money analysis before the preferred procurement form is confirmed in mid-2009

The PV guidelines require the development of a detailed Public Sector Comparator (PSC) as the basis for determining whether the preferred bid offers value for money. Government makes this decision by comparing the whole of life costs, while taking account of the allocation of risks between the public and private sector.

The Department is working to develop a detailed PSC and advance the procurement process to the stage where it can present the value for money analysis to Government. Judgement on the procurement process will have to wait until this work is completed.

3.5 Victorian Water Trust (VWT)

3.5.1 The objectives of the VWT are consistent with Government policy goals and objectives

The Minister for Water is responsible for allocating funding from the VWT, while the VWT advisory council is responsible for advising the Minister about these decisions.

The objectives of the VWT are wide ranging, consistent with the white paper's policy goals and do not constrain the allocation of these funds to the Government's highest priorities.

¹⁰ Melbourne Water, *Seawater desalination feasibility study*, prepared for the Department of Sustainability and Environment, Melbourne, 2007.

¹¹ PricewaterhouseCoopers, *Desalination procurement options analysis—full report*, prepared for the Department of Sustainability and Environment, Melbourne, 2007.

3.5.2 The VWT advisory council used clear and sound planning processes to recommend funding for projects valued at \$110 million

The VWT advisory council identified priority areas for investment taking account of the directions set out in the white paper

The council's 2005 Business Directions Plan set out the VWT's strategic direction identifying the following priority areas:

- water sensitive urban design
- major recycling
- aquifer storage and recycling
- desalination
- water use efficiency.

The VWT advisory council chose these areas because the white paper identified the need to develop technologies and solutions in these emerging areas.

The VWT advisory council worked to promote awareness of the importance of these areas and to encourage a wide range of submissions. Council members hosted workshops, prepared case studies and demonstration projects and participated in relevant conferences.

The VWT advisory council's appraisal of submissions and its recommendations for project funding were sound

Each submission had to provide a business case conforming to the VWT advisory council's guidelines. The processes included:

- a preliminary assessment of each submission by the VWT advisory council
- a more detailed, scorecard assessment of those projects passing the preliminary assessment
- a final review of the assessment results by the VWT advisory council before finalising funding recommendations.

The scorecard assessment took account of the VWT's objectives and priorities, the costs, benefits, risks and technical feasibility. The VWT advisory council's recommendations were accepted and funding provided in the 2006/07 budget.

3.5.3 For the remaining funding, \$160 million funded the Government's 2002 election commitments and \$50 million has been transferred as a Government contribution to the Victorian water plan

Projects included in the 2002 election commitments

These projects were not subject to the same project appraisal and selection processes as the phase two projects because they pre-dated the formation of the VWT advisory council.

While they pre-date the white paper, the focus of the phase one projects on conservation, recycling and healthier rivers was consistent with Government policy as reflected in the subsequent white paper. The Department was not able to provide audit with the information used to assess and select these projects for funding.

\$50 million third phase of VWT funding has now been allocated to the Victorian water plan

The Minister has directed most of the remaining VWT funding as part of the Government's contribution to the food bowl project, within the Victorian water plan. This action is within the powers defined in setting up the VWT.

4 Monitoring and reporting on strategies

At a glance

Background

Monitoring the implementation of agreed actions and collecting information to determine their success is critical for good public sector management, and in some areas it is a legislated requirement. We assessed whether the Department of Sustainability and Environment had applied adequate processes to monitor the progress of water infrastructure plans and evaluate their impacts.

Key findings

- The Department has improved the monitoring and reporting of its plans and strategies.
- The Department has effectively acted on most of the white paper actions, but drought-related demands have led to some important actions falling behind schedule.
- More up-to-date information on progress in achieving the white paper actions and outcomes should be provided.
- The Department proposes to improve how it tracks and reports on the actions in the Central Region strategy.
- Insufficient information is published on the progress and impact of projects funded by the Victorian Water Trust.

Key recommendations

The Department should:

- provide regular, consolidated reports on progress against the actions and outcomes within the white paper and the sustainable water strategies
- publish information on the progress and impact of projects funded by the Victorian Water Trust
- validate the flow compliance information provided by Catchment Management Authorities (CMAs) and make the CMAs' operating and compliance reports available to the community
- regularly make available, to the community, information about how well the Department has met its environmental flow obligations.

4.1 Background

4.1.1 Importance of monitoring and reporting on plans

Monitoring the implementation of agreed actions and collecting information to determine their success is good management practice, and in some areas, a legislated requirement.

As a matter of good management practice the Department needs to monitor the progress of actions within finalised plans, understand how well these plans have achieved their objectives, and appropriately respond to this information to improve performance.¹

The Department also has specific, legislative obligations to:

- report in its annual report on any long-term water resources assessment
- report on any current sustainable water strategies within its annual report specifying implementation actions and priorities²
- develop a framework for monitoring and evaluating the implementation of regional catchment strategies³
- develop a program to review and audit the provision and effectiveness of environmental flows.⁴

4.1.2 The content and structure of this part of the report

We assessed the adequacy of the Department's monitoring and reporting by examining whether the Department had applied processes to:

- monitor whether the whole-of-state and regional plans had been implemented as intended
- evaluate the impact of strategies and their combined contribution to the achievement of overall water sector goals
- adjust the state and regional plans where actual outcomes or altered circumstances require this.

In the following section we firstly describe how the Department is developing the way it monitors and reports on its plans and strategies.

The remaining sections describe our assessment of the Department's performance in monitoring: the white paper; the Central Region strategy, the activities of the Victorian Water Trust, and environmental flows.

¹ *Water Act 1989*, Section 22U.

² *Ibid.*, Section 22J.

³ State Environment Protection Policy (Waters of Victoria), Section 19.

⁴ *Ibid.*, Section 41.

4.2 Departmental monitoring and reporting

4.2.1 The Department has improved the monitoring and reporting of its plans and strategies

The Department introduced 'Business Progress Reporting' (BPR) in 2005 to better monitor and manage its obligations and activities

The Department introduced the BPR system in 2005 to identify and track the progress of projects in a standard format. The Department's Office of Water reports progress using the BPR information on a monthly basis and tracks, in greater detail, a smaller set of critical projects.

Before the introduction of this system project directors and managers tracked progress and escalated issues through the Department's corporate structure on a discretionary basis.

For each project, the BPR system:

- identifies the owner, the manager
- describes the purpose
- tracks progress and any amendments to the key milestones
- describes the nature and seriousness of the risks to timely and successful completion.

Of all the projects captured by the BPR system, 20 per cent required a management review and a full risk assessment

The Department conducted a review which rated projects in terms of their:

- attributes including size, risk profile and importance to the organisation
- the level of documented management approval in terms of the existence of formal business and implementation plans
- performance taking account progress against milestones, financial performance and BPR status.

In May 2007 the review recommended that:

- 16 projects (20 per cent) required a full risk assessment
- a further 15 projects (19 per cent) were tracking well and required only routine management reporting
- the remaining 48 projects required management responses to the small number of categories identified as underperforming.

We have taken account of this information in our assessment of project monitoring and implementation.

The Department reorganised the Office of Water in the second half of 2007⁵ to better meet Government's need to address the emerging challenges in the water sector

The senior management within the Office of Water reviewed the role and key operational responsibilities of the office in the light of the 'Our Water Our Future' policy agenda and the likely demands of an emerging national water policy. The refined divisional structure was designed to better meet these needs and challenges.

In terms of monitoring and evaluation the structure should:

- provide a strong focus on governance, monitoring and reporting
- define clear accountabilities
- provide stronger internal management arrangements.

The new Water Industry Division is now responsible for project governance, program implementation and monitoring and information management.

4.3 Monitoring and reporting on the white paper

4.3.1 The Department has effectively acted on most of the white paper actions, but drought-related demands have led to some important actions falling behind schedule

The Department has made significant progress in implementing most of the actions flagged in the white paper

The Government amended the *Water Act* in 2005 to:

- establish the legislation allowing environmental entitlements through the creation of Environmental Water Reserves
- create a new, lower reliability, tradable entitlement
- introduce requirements to improve long-term, water resource planning through the preparation of sustainable water strategies and water resources assessments
- introduce the legal basis for the creation of a Victorian Water Register as a precursor to the unbundling of water entitlements from land rights.

The Department has progressed many of the other actions which followed on from, or did not directly rely on the legislative changes. For example the Department has delivered:

- a Victorian Water Register and associated water trading system as an integral part of the project to unbundle water and land rights
- upgraded information systems to understand groundwater and surface water resources

⁵ Internal departmental paper on the proposals to restructure the Office of Water, June 2007.

- the annual State Water Report including water accounts for each river basin in Victoria
- the Central Region sustainable water strategy.

The most important example of a delay is in the completion of sustainable water strategies covering all of Victoria

The sustainable water strategies are the foundation of long-term, inclusive planning for water resources. The white paper flagged five strategies covering Central, Northern, South-Western and Western Victoria and Gippsland. These were scheduled for completion by 2008 and this remains the Department's target.

The Department completed the Central Region strategy in October 2006.

The Department released the discussion paper for the Northern Region strategy in January 2008. The closing date for submissions is in March, with a draft strategy scheduled for release in mid-2008 followed by the final strategy in early 2009.

The strategies covering Gippsland and Western Victoria (including the South-West and the Wimmera) are unlikely to be delivered by the end of 2008:

- the November 2007 BPR system reports show that preparatory work for these strategies started in late November 2007
- the work plans for the strategies are scheduled for completion in early March with the development of the programs, oversight arrangements and budgets to be finalised by June 2008
- in this context, finalising robust, well-founded and inclusive strategies for the Gippsland and Western regions is likely to stretch beyond 2008.

The worsening of the Victorian drought has required the Department to divert specialist resources away from work on the strategies to other urgent tasks.

4.3.2 More up-to-date information on progress in achieving the white paper actions and outcomes should be provided

Since the second half of 2006, the Department has relied on the BPR system to track specific projects

Up until the second half of 2006 the Department tracked progress through a consolidated (Excel) database of the white paper's actions. White paper actions are now monitored through the BPR system reports.

A comprehensive understanding of progress against the actions listed in the white paper cannot be reached from the current reporting. This is explained in part by the size and complexity of the white paper and the number of actions (and sub-actions) listed in the document. The maintenance of an up-to-date, consolidated database would help fill this gap.

Given the importance of the white paper and the contribution of stakeholders and the wider community to its development, the Department should maintain a consolidated database of white paper actions populated from the BPR system and other data sources.

Regular, consolidated reports on progress against the white paper actions and outcomes should be published

The Department published the report *Progress Towards Securing Our Water Future* in October 2005, some 16 months after publishing the white paper. The report provided information on the progress to date. The Department has not issued information along these lines in the two years since this publication.

There is a need to update the community on the Department's achievements and any delays in relation to the white paper's actions. The report should cover how well the actions have achieved the white paper's objectives.

4.4 Monitoring and reporting on the Central Region sustainable water strategy

4.4.1 The Department proposes to improve how it tracks and reports on the actions in the Central Region strategy

The Department has tracked the progress of the strategy through an Excel database, the BPR system, and information from water authorities

The strategy team created a spreadsheet database to track the progress of the 129 actions included in the final strategy. While the tracking spreadsheet contains useful information, the version we reviewed was not complete or current for all actions.

The BPR system includes projects incorporating some of the strategy actions.

Water companies and CMAs generate reports tracking some aspects of the strategy including water conservation and recycling (the metropolitan retailers) and the achievement of environmental flows through annual watering plans. Currently this information is not published by the Department.

The Department committed to publish an annual review of the Central Region strategy in 2007

A key commitment of the strategy was an annual review which will:⁶

- improve the public's understanding of the progress in meeting the strategy's targets
- report on any variance in the actual water supply and demand from the forecasts contained in the strategy
- provide commentary on the key factors driving the variances in the actual data from the forecast
- assess and report on the validity of the assumptions underpinning the forecasts
- assess water authorities' performance against the targets stipulated in the strategy, for example in relation to conservation and recycling
- monitor river flows and the progress in achieving environmental targets for river health.

⁶ PricewaterhouseCoopers and Snowy Mountains Engineering Corporation, *Department of Sustainability and Environment—Central Region Sustainable Water Strategy Annual Review Framework*, prepared for the Department of Sustainability and Environment, Melbourne, 2007, p.6.

Delivering on these objectives will:

- greatly improve the publicly available information on the strategy's progress and outcomes
- provide a trigger for reassessing the strategy's assumptions if changed circumstances have undermined the basis for the strategy.

The report was due to be published by the end of 2007 but had not been published by the end of March 2008. Hence we have not had the opportunity to review its contribution to improved monitoring.

The level of detail of the Department's 2006-07 annual report on sustainable water strategies was insufficient for it to meet its reporting obligations

The Department is required to specify: 'the measures being taken to implement the Strategy', and identify, 'the priorities that apply to actions required by the implementation plan'.⁷

The Department included the following text in the 2006/07 annual report:

'In October 2006, following a two-year development and community engagement process, the Central Region Sustainable Water Strategy (CRSWS) was released. Its 129 actions are now being implemented—some accelerated in response to ongoing drought conditions in Melbourne and Geelong—by government in partnership with a wide range of stakeholders including water authorities, catchment management authorities and Victorian communities.'

This short summary does not describe the strategy's actions or the priorities that apply to these actions.

An accurate assessment of the status and the progress of the strategy actions cannot be formed from this information

We reviewed a spreadsheet tracking all of the 129 strategy actions dated October 2007 and found that the information did not allow us to understand each project's status. Specifically we found that:

- 58 projects were 'in progress' and 11 of these had been accelerated in response to the drought
- we did not have sufficient information for 55 projects to understand their status
- four projects had been completed
- the remaining projects had been delayed by the continuing drought, and in one case abandoned.

⁷ *Water Act 1989*, Section 22J.

The strategy team's more recent update assessment of progress in November 2007⁸ reported that of the 129 actions:

- 6 per cent had been completed
- 60 per cent were on schedule or near completion
- 21 per cent were ongoing actions
- 13 per cent were behind schedule.

The Department has recognised the need to improve how it tracks and reports on the progress of the Central Region strategy

The Department provided a draft document setting out proposed reporting protocols.

The document proposed:

- setting up a formal system to monitor actions through an action tracking database
- assigning the overall coordination to the Water Industry Division within the Office of Water
- identifying the departmental personnel responsible for collecting and collating information on each action
- linking to existing information, such as the BPR reports, where the Department already reported on strategy actions
- using this tracking system to provide accurate, comprehensive and complete information on the strategy actions to meet monthly, quarterly and annual reporting requirements.

We support this proposal as a necessary step to improve the way the Department tracks and reports on the progress of the sustainable water strategies.

4.4.2 The Department should implement its own proposals to improve how it tracks and reports on the Central Region strategy actions

The annual review of the Central Region strategy provides the opportunity to report on the outcomes related to water authorities' *Statements of Obligations*. The application of the Department's proposed framework for improved data collection, analysis and reporting should further improve the quality of monitoring information made available to the community.

⁸ Draft text for inclusion in the DSE 2007 Annual Report in response to reporting requirements for regional sustainable water strategies under Section 22J of the *Water Act 1989*.

4.5 Monitoring and reporting on the Victorian Water Trust

4.5.1 Insufficient information is published on the progress and impact of projects funded by the Victorian Water Trust (VWT)

The mid-2006 VWT evaluation report did not allow the reader to understand whether or not projects were progressing as planned. Table 1 of the report lists the current and future VWT investments with a line for each to indicate the planned duration of each project. The document provided no information on progress against these timelines and whether VWT funds were spent as scheduled.

We found no other source of publicly available information to inform the community on the progress of these projects

The State budget papers contain a single line item for the VWT. The Department's website contained no detailed information to address the absence of basic information on project progress.

Departmental records showed that a small number of VWT projects had fallen behind schedule

We based our analysis on the following reports:

- the VWT progress report to the VWT advisory council for the period up to June 2007, which documented actual and budgeted expenditures for 20 projects funded by the Trust. This report is assembled by the VWT secretariat within the Department
- the VWT project register, a listing of actual expenditure by project produced by the Department's finance division covering the same time period
- Business Progress Reporting (BPR) documents for VWT projects dated November 2007.

For the period up to June 2007, we compared the budgeted expenditure listed in the VWT progress report with the actual expenditure documented in the VWT project register. Of the 20 projects listed in the progress report, seven were underspent by more than \$1 million and of these three were underspent by more than \$3 million.

Our review of the Department's BPR documents showed that, for most of these projects the timeline slippages were small. The clear exception is the Sunraysia Irrigation project where the contract award for pipe supply and installation was nine months behind the original milestone date. For this project the actual expenditure to June 2007 was \$6 million against budgeted expenditure of \$19.85 million.

This information is not accessible to non-government stakeholders and the community.

Our review also found that \$10.171 million had been transferred from VWT projects to the Wimmera-Mallee pipeline in 2006/07. This is due to be repaid in 2007/08. The VWT projects affected and the amounts involved were:

- Goulburn Broken (\$4 million)
- Sunraysia Irrigation (\$5.68 million)
- Gippsland Lakes and MacAlister River (\$0.49 million).

Particular components of the Wimmera-Mallee pipeline project, part funded through VWT, were accelerated in 2006/07 in response to prolonged drought to ensure supply was available to customers.

To facilitate the acceleration, an advance on funding was required. Some of this was sourced from the Commonwealth and \$10.171 million was transferred from other VWT projects. The temporary transfer was agreed within the Office of Water by the responsible project managers in consultation with the project delivery agencies.

4.5.2 The Department should publish information on the progress and impact of projects funded by the Victorian Water Trust (VWT)

While part of the VWT advisory council's role is 'Promoting public awareness of the activities of the Council', the council is not required to report on progress to the community.

Nevertheless, the Department should provide timely updates on the progress of VWT projects, including actual against planned spending and timelines, the reasons for any delays and evidence of the impacts after projects have been completed.

4.6 Monitoring environmental flows

4.6.1 The Department has put in place a framework to measure compliance with environmental flows and their impact on environmental outcomes

Environmental outcomes are managed by placing conditions on the extraction of water from rivers and storages, and allocating a share of the available water for environmental flows

Water is managed in two ways to benefit the environment:

- passively, where water authorities must comply with caps on the volumes taken for other uses and requirements for minimum flows at specific points along the waterway

- actively, where environmental water is held in storage to be actively used by an environmental water manager (normally the CMAs) to meet specific objectives.

The passive measures are set out in the bulk entitlements under which water authorities take water from storages and rivers.

The active measures are set out in the environmental entitlements including the volume of water set aside for the environment.

CMAs are responsible for producing a (three to five-year) environmental operating plan and an annual watering plan to guide the use of environmental water.

The Department is required to develop a program to review and audit the provision of environmental flows and their effectiveness in protecting the environment⁹

The Environmental Water Reserve (EWR) includes water that is legally set aside for the environment, as an environmental entitlement, or through the operation of the conditions on any bulk entitlement, licence, permit, authority or management plan.

The white paper included the requirement to establish EWRs across all Victorian rivers and the *Water Act* included legislation to do this.

The Department's EWR management program builds on the legislation to provide clear objectives for the management of water for the environment, and information to the community on the use and benefits of environmental water management.

The Department monitors compliance through the activities and reports of the CMAs and is working to strengthen processes to verify this information

CMAs provide the Department with an annual compliance report which documents:

- compliance with environmental bulk entitlements and environmental entitlements
- the delivery of the flows set out in the annual watering plans and the reasons for any variation
- compliance with the long term flow targets set out in the environmental operating strategies.

Water authorities report to the Minister for Water on how they complied with the conditions of any entitlements they hold. This information is also used in the CMAs' compliance reporting.

The Department manages the accuracy and completeness of information on flows through its monitoring procurement process for the regional monitoring partnerships. These partnerships include government departments, the Environmental Protection Authority, CMAs and water authorities.

⁹ State Environment Protection Policy (Waters of Victoria), Section 41.

These partnerships provide an integrated and consistent statewide approach to monitoring water flows. The Department is responsible for managing contracts which specify the monitoring standards and methods agreed by all the partners.

The State Water Report is a valuable source of published information on the compliance with environmental requirements including some of the information provided in the CMAs' compliance reports.

However, the *State Water Report 2005/06* commented that: 'Information on whether water authorities had met passing flow requirements was not uniformly reported, and in some instances compliance could not be fully reported as necessary metering and instrumentation were not in place during 2005/06.'¹⁰

The Department is working to address these issues by requiring water authorities to prepare and implement bulk entitlement metering plans and independent, compliance audits. The Department has prepared guidelines for bulk entitlement metering plans but further work is required by water authorities and the Department to document and sign-off on these plans. The Department has yet to finalise its requirements relating to the independent audits of these entitlements.

The Department is implementing a monitoring and assessment process to measure the effectiveness of the EWR

The Department has developed the Victorian Environmental Flows Monitoring and Assessment Program (VEFMAP) to improve the way it monitors the effectiveness of the EWR Management Program.

The Department in conjunction with the CMAs has established this program for the eight rivers for which EWRs have been defined.

The VEFMAP program is currently reported to the community through papers that are submitted to the scientific journals as well as conference papers. At the completion of the VEFMAP three-year program the final report will be released as a public document. The Department should also summarise the key findings and provide access to this summary through its website.

The January 2008 BPR reporting shows that the project is largely on-schedule.

¹⁰ Department of Sustainability and Environment 2007, *State Water Report 2005/06*, Department of Sustainability and Environment, Melbourne, p.50.

4.6.2 The Department should validate the flow compliance information provided by Catchment Management Authorities (CMAs) and make the CMAs' operating and compliance reports available to the community

The Department does not have currently have:

- comprehensive processes in place to validate the accuracy and completeness of the information on compliance with passing flows
- links on its website to provide public access to the more detailed information on planning and compliance within the CMAs' environmental operating plans, annual watering plans and compliance reports.

The Department's current work with water authorities to implement metering plans and independent audits provides the opportunity to address the validation issue.

The Department should regularly make available information about how well it has met its environmental flow obligations.

5 Governance

At a glance

Background

Public sector governance encompasses the manner in which public sector organisations acquit their responsibilities by being open, accountable and prudent in decision-making, in providing policy advice, and in managing and delivering programs.

We examined the governance processes and arrangements for selecting and prioritising water supply strategies. We applied the principles of transparency and openness, accountability and stewardship.

Key findings

- The water sector institutional arrangements are not a barrier to the appropriate selection and prioritisation of water infrastructure projects. However, the metropolitan water retailers should be brought under the same governance arrangements as other water authorities.
- Furthermore, the roles of public sector agencies in reviewing the currency of existing strategies need clarification.
- The water sector governance arrangements provide the means to direct water authorities to fund Government's high priority projects.
- There is a pressing need to develop arrangements to effectively and efficiently manage the metropolitan water supply system in light of the Victorian water plan commitments.

Key recommendation

- The Department should strengthen the processes it uses to review water authority plans to verify they conform with Government policy objectives and that their projects and initiatives meet value for money criteria.

5.1 Background

5.1.1 The attributes of governance examined

Public sector governance encompasses the manner in which public sector organisations acquit their responsibilities by being open, accountable and prudent in decision-making, in providing policy advice, and in managing and delivering programs.¹

We examined the governance arrangements underpinning the selection and prioritisation of water supply strategies using the principles of transparency and openness, accountability and good stewardship, following the ANAO's better practice guide.²

5.1.2 The content and structure of this part of the report

We have structured this part of the report into the following sections following these key governance principles:

- **transparency and openness:** 'required to ensure that stakeholders can have confidence in the decision-making processes and actions of public sector organisations, ...meaningful consultation with stakeholders and communication of full, accurate and clear information, leads to effective and timely action and stands up to necessary scrutiny'.
- **accountability:** 'is the process whereby public sector organisations, and the individuals within them, are responsible for their decisions and actions ... and submit themselves to appropriate external scrutiny. It is achieved by all parties having a clear understanding of those responsibilities, and having clearly defined roles through a robust structure'.
- **stewardship:** 'Agencies are the stewards of the State's resources. Agencies are responsible for the efficient and effective management of resources. This requires objectivity and a commitment to an evidence-based approach when recommending improvement strategies'.

As part of our review we examined:

- the draft Victorian Competition and Efficiency Commission (VCEC) report on the structure of the metropolitan retail water industry and the submissions to this inquiry
- a departmental report on water sector governance arrangements.³

¹ Australian National Audit Office 2003, *Public Sector Governance—Better Practice Guide*, Australian National Audit Office, Canberra.

² *Ibid.*, p.8, Volume 1.

³ PricewaterhouseCoopers, *Department of Sustainability and Environment - Water Industry Governance Review*, draft report, prepared for the Department of Sustainability and Environment, Melbourne, 2006.

5.2 Transparency and openness

5.2.1 The development of the Victorian water plan did not have the same transparency and openness used to inform the white paper and Central Region strategy

The requirements for a short term response to an emergency situation meant the Department could not follow the previous comprehensive planning processes

The Department provided stakeholders with information so they could fully participate in the development of the white paper and the Central Region strategy. In consequence stakeholders showed a high level of support for the white paper and Central Region strategy processes and outcomes.

The Department was required to develop the plan as an emergency response and so did not have time to use the same processes successfully employed to develop the white paper and Central Region strategy.

The approach to the Victorian water plan made it more difficult to secure stakeholder support and the tight timelines meant that stakeholder concerns could not be resolved before decisions were taken.

The plan and announcements described the need for immediate action, consistency with the Government's policy position and the way components would be delivered

The plan explained how the record low inflows of 2006 had prompted Government to address this heightened level of risk by:

- advancing some of the major water augmentations flagged in the Central Region strategy (the desalination plant)
- committing to additional measures to mitigate the risk of short term shortages
- expanding the water grid to make sure water could be transferred to the areas of greatest need.

The plan stated the costs of the component projects and the timelines for their delivery. Following detailed cabinet consideration, a further announcement in September 2007 stated that the desalination plant would be delivered as a Public Private Partnership.

5.2.2 When publishing information on committed projects the Department should explain to the community the level of rigour underpinning project costs and benefits

The available information did not show the extent of the work or level of rigour underpinning the plans' costs and decisions. For example, the plan did not include an indication of the precision of the cost estimates for the component projects.

The reliability of the estimated costs and risks identified varied significantly across the projects. The published material should have included a clear explanation of the level of rigour used to inform the plan's commitments.

In responding to an emergency situation, it is understandable that some projects might need to be formed with less than the normal level of rigour associated with an expenditure commitment. The Department needs to be open about this and set out a clear process for refining the less rigorous information.

5.2.3 The Department's reporting to the community on the progress and impact of water supply strategies is currently inadequate

Part 4 of this report identified several ways in which the Department needs to improve the way it provides the community with information on water supply strategies.

5.3 Accountability

5.3.1 The roles of public sector agencies in reviewing the currency of existing strategies need clarification

The current arrangements and roles, while complex, provide a sound basis for water resource planning

The current legislated framework involves:

- the portfolio interests of three ministers (Minister for Water, Minister for the Environment and the Treasurer) supported by DTF and DSE
- the state-wide and regional water resource planning and management responsibilities of DSE
- the water authority oversight responsibilities of DSE and DTF
- the regulation of water authorities by four agencies including DSE
- the planning and operational responsibilities of metropolitan, regional and rural water authorities.

Water authorities are constituted under the *Corporations Act* (the metropolitan retailers) or under the *Water Act* (Melbourne Water and the regional and rural water authorities).

Under this framework all water authority boards are accountable for:

- forming plans consistent with Government policy, financial performance objectives and state-wide and regional strategies
- proposing prices through the regulatory process overseen by the Essential Services Commission
- effectively implementing their plans
- monitoring the plans' outcomes and reporting on these to Government.

The effective application of these arrangements requires:

- the definition of clear and measurable objectives by Government departments
- operational autonomy for water authority boards to deliver on these objectives
- the effective monitoring of performance by departments.

The Department needs to improve the application of the current framework and consider whether its structure needs to be changed in light of the Victorian water plan

The Department commissioned a review of the governance in the water sector which reported in draft in July 2006 and found that the governance framework was clear and sound.⁴

However, the draft report recommended action to address perceived weaknesses in the application of the framework. In particular:

- the *Statements of Obligations* needed to be improved as an instrument for clearly defining the obligations of water authorities
- the departments with planning and oversight responsibilities (DSE and DTF) needed to limit their involvement in the operational decisions of water authorities so that their actions did not undermine boards' accountabilities
- the mandatory review and approval of all projects over \$5 million by the Minister for Water and the Treasurer did not encourage boards to be accountable especially for the larger water businesses (for example, the \$5 million threshold is very low for Melbourne Water which has a turnover exceeding \$500 million).

This draft review of governance pre-dated changes to the *Water Act* to make further amendments to governance and the operation of water authority boards.⁵

⁴ PricewaterhouseCoopers, *Department of Sustainability and Environment - Water Industry Governance Review*, draft report, prepared for the Department of Sustainability and Environment, Melbourne, 2006.

⁵ *Water (Governance) Act 2006*.

In the current VCEC inquiry the same application issues are being raised in submissions:

- 'City West Water suggests the current governance arrangements be reviewed to clarify and if possible simplify the various roles and responsibilities of government as policy maker, shareholder, regulator and service deliverer. This review should ensure the arrangements support the new sources of supply, expedite the expansion of the Victorian water grid and rationalise what might become outdated or inconsistent regulatory instruments.' (*City West Water* submission, page 2)
- 'All capital projects over \$5m require government approval and this tends to blur the roles and responsibilities of directors. Ideally the company Constitution would make it clear what decisions shareholders wish to retain versus those it delegates to the directors and management. The current Constitution does not do so.' (*City West Water* submission, page 48)
- 'The shareholder role of Government is currently split between two Ministers and their departments. Approval of \$5m capital projects by Government departments dilutes Board accountability if it operates to second guess business cases. The approval limit should be increased (it has been \$5m for over a decade) and the approval process should be focused on ensuring broader Government policy objectives are included in water business decisions.' (*City West Water* submission, page 49)
- 'With three Ministers in Victoria (Minister for Water, Minister for the Environment and the Treasurer) having portfolio interests in the water industry, each with distinct priorities, clear accountabilities will contribute to effective coordination, policy development and delivery. These should be set for ministers, departments and water utility boards.' (*Yarra Valley Water* submission, page 21)
- 'Yarra Valley Water believes there should be clear separation of the Government's policy making and shareholder roles, consistent with COAG's water reform framework.⁶ This needs:
 - clear and concise roles and responsibilities for all participants (utilities, shareholders, policy makers)
 - clear objectives for the supply and use of water
 - greater shareholder oversight to ensure focused and effective monitoring of performance.' (*Yarra Valley Water* submission, page 86)

In terms of governance-related changes VCEC recommended that:

- 'the retailers be made statutory corporations under the *Water Act* (7.3)
- 'the threshold for review by the Department of Treasury and Finance of water retailers' capital works be raised from the current amount of \$5 million and be based on a percentage of capital expenditure' (7.4).

Given the increasing role of the Department in metropolitan water planning, audit supports VCEC's recommendation (7.3) that the metropolitan retailers be brought under the same governance arrangements as other water authorities.

⁶ Council of Australian Governments, *Intergovernmental agreement on a national water initiative*, June 2004.

The \$5 million threshold for reviewing the retailers' capital works needs to be reassessed so that resources are focussed on expenditures which are critical to policy outcomes and where departmental scrutiny can add most value.

The role and key assumptions of the Central Region strategy need to be updated

The water authorities in the Central Region based their draft water plans on inflow assumptions consistent with the strategy, while making allowance for the Victorian water plan augmentations. The strategy assumed that the average, drought affected inflows of the past ten years would continue into the future.

The Victorian water plan committed funding of \$4.9 billion to augment water supplies over the next five years based on the continuation of the lower inflows of the past three years.

The Essential Services Commission (ESC) submission⁷ to the VCEC inquiry identified the potential for lowering the retailers' proposed price increases by reducing operating expenditures and assuming higher water demand forecasts.

The retailers planned to achieve the Central Region strategy's water conservation targets. The ESC suggested that conservation expenditures could be reduced once the recently announced water augmentation projects come on-line.⁸

The ESC considered that the retailers demand estimates were conservative and should be revised upwards⁹ because:

- forecasts based on the last ten years' inflows are too pessimistic
- the new supply augmentations will lead to a quicker relaxation of water restrictions than assumed in the retailers' water plans.

The VCEC draft report supported the ESC's views on the demand estimates.¹⁰

The scale and significance of the Victorian water plan augmentations mean the Department needs to review Central Region strategy objectives, targets and priorities. This review is essential so that water authorities have a clear framework for planning their activities and discharging their statutory responsibilities.

The Department needs to initiate a full review of the strategy and coordinate this with a review of the governance arrangements (see Section 5.4.2 below).

⁷ Essential Services Commission, Submission to the Victorian Competition and Efficiency Commission Inquiry into Reform of the Metropolitan Retail Water Sector, 2007.

⁸ Ibid., p.6.

⁹ Ibid., pp. 8–10.

¹⁰ Victorian Competition and Efficiency Commission 2007, *Water Ways: Inquiry into Reform of the Metropolitan Retail Water Sector*, draft report, Victorian Competition and Efficiency Commission, Melbourne, p.XXVII.

5.4 Stewardship

5.4.1 The water sector governance arrangements provide the means to direct water authorities to fund the Government's high-priority projects

The *Statements of Obligations*, issued to all water authorities as part of the regulatory price setting process, provide Government with the opportunity to define its policy outcomes, targets and priority actions.

In formulating their five-year water plans, authorities must address the *Statements of Obligations*. ESC reviews these plans to determine whether they will deliver on the obligations cost-effectively. ESC amends the plans in the light of this review.

The Government may also 'direct' water authorities' boards (except the metropolitan retailers) to carry out additional actions outside of the *Statements of Obligations*. This provides an additional mechanism by which Government can direct the action of water authorities.

In addition, the Government is able to affect the retailers' actions by:

- amending their *Statements of Obligations*, or
- requesting changes as the retailers' only shareholder.

The funding arrangements provide flexibility to respond to changes affecting the achievement of policy goals. The development of the Victorian water plan and the commitment of \$4.9 billion to deliver the plan in a six-month period show that the arrangements have the required flexibility.

5.4.2 The arrangements provide mechanisms for reviewing the costs, benefits and risks of water supply strategies and plans

The VCEC draft report highlighted the need to include more information on the costs and benefits of projects included in water plans

The VCEC report recommended the introduction of regulatory impact statements.

When viewed in the context of the wider planning, review and reporting processes, the current arrangements provide the opportunity to assess the effectiveness of the water plans but need to be strengthened

The arguments here parallel those used to support the arrangements with respect to selecting priority projects in-line with Government's desired outcomes.

These processes include:

- providing the opportunity for ESC, the Department and regulators to scrutinise the plans
- the review of water authorities' projects within other, Government-endorsed strategies
- business case reviews where the Department assesses the likely effectiveness of projects costing over \$5 million
- water authorities reporting on the performance indicators specified by ESC. In addition, the retailers regularly report to the Department on their achievements with respect to conservation and recycling.

The mechanisms exist to review water authorities' plans in terms of value for money and how they have interpreted policy and for value for money.

However:

- the ESC does not complete a rigorous value for money assessment of projects which directly address a Government policy, for example, in relation to conservation or recycling targets
- the effective application of these mechanisms relies on the quality of the Department's reviews of water plans and the business cases put forward for significant projects
- the quality, consistency and timeliness of these Departmental reviews need to be assessed.

5.4.3 The Department should strengthen the processes it uses to review water authority plans to verify they conform with Government policy objectives and that their projects and initiatives meet value for money criteria

The VCEC draft report into the metropolitan water sector recommended changes to the *Statements of Obligations* to clarify the Government's required outcomes and water companies' obligations

The *Statements of Obligations* include a set of generalised principles designed to guide the formation of water plans (for example 'manage water resources in a sustainable manner' and 'minimise the impacts of its activities on the environment').

The VCEC report argues that describing outcomes and translating these into specific targets would:

- better inform water authorities about Government's expectations and enable them to better manage the inevitable (cost-constrained) trade-offs between outcomes
- help ensure that obligations clearly relate to outcomes
- provide the basis for performance measures.

VCEC recommended 'that for each pricing period the Government specify in the statement of obligations the quantifiable outcomes that it expects the retailers to achieve through meeting these obligations.'

The VCEC draft report noted on page 144 that some obligations are quite specific while others leave considerable room for interpretation. For example:

- the retailers must specifically meter all new water use
- but, obligations for the sustainable use of recycled water and responding to climate change are far less specific.

VCEC acknowledged:

- South East Water's view (page 145) that the arrangements should leave service providers to deliver against defined outcomes without prescribing the solutions in detail. This is consistent with board accountability for planning to deliver against clear high level objectives
- that the current process already permits some scope for scrutiny and the consequent revision of obligations (page 144).

However, VCEC was concerned that imprecise obligations may lead the retailers to:

- interpret the obligation and its relative priority differently and reflect this in varying levels of expenditure for similar actions
- make decisions on trade-offs between non specific obligations covering commercial and public interest objectives, which better lie with Government.

The VCEC draft report illustrates how the interpretation of obligations can affect costs and prices by referring to City West Water's and Yarra Valley Water's draft plans:

- City West Water attribute about \$20 million of their increased operating expenditures to conservation and recycling projects
- Yarra Valley Water has projected an \$18.4 million increase in expenditure to deliver water consumption reductions. It has also responded to the sustainable management obligation by planning to make sure its activities are carbon neutral by mid-2008.

The VCEC draft report put forward two options to address these issues:

- improving the current process by requiring: more information on the options considered to address obligations; linking this analysis directly to the intended outcomes; allowing more time for feedback on the draft plans from ministers, regulators and the public, and publishing ministers' and regulators' comments
- requiring the Minister to prepare a regulatory impact statement for new or amended obligations accompanied by a statement of the outcomes the obligation is intended to achieve.

The VCEC draft report recommended the use of regulatory impact statements, which would be consistent with the Government's approach to other areas of regulation.

There are additional mechanisms to direct water authority funding in line with Government's priorities

The ESC scrutinises water authorities' plans to determine whether they will efficiently deliver on the statement of obligations. The ESC can raise areas where there are differences in interpretation. The ESC will take account of the ministers' comments on the draft water plans when making final determinations.

An assessment of the adequacy of the *Statements of Obligations* needs to take account of the Government endorsed strategies referenced in these statements. These include:

- Central Region strategy (Section 25c) which sets specific conservation and recycling targets for the region
- the water demand-supply strategy (Section 17) developed by Melbourne Water and the three retailers to consistently apply the objectives and targets within the Central Region strategy to the metropolitan area
- metropolitan water and conservation recycling plans (Section 16), which set targets for each of the retailers and Melbourne Water in achieving overall, metropolitan targets. The retailers' programs must be consistent with these plans.

These strategies clarify expenditure relating to conservation and recycling and these are the major areas of spending where VCEC asserts there is a lack of clarity.

In addition to reviewing retailers' draft plans, the Department must endorse a business case for any project with expenditure exceeding \$5 million. These mechanisms provide the opportunity for the Department to question the consistency and interpretation of water authorities' plans.

In summary, the audit found that the Department needs to improve its review of water authority plans to provide assurance that they conform with Government policy and deliver value for money. To do this the Department should strengthen the processes it currently uses to review these plans.

5.4.4 Some components of the Victorian water plan were underpinned by information of inadequate quality

As highlighted in Part 3 of this report, this was particularly the case for the food bowl modernisation project.

In this type of urgent response situation the Department needs to mitigate the challenge by advising the community how it plans to progressively develop better quality information, and use this information to confirm the projects' viability.

5.4.5 There is a pressing need to develop governance arrangements to effectively and efficiently manage the metropolitan water supply system in light of the Victorian water plan commitments

Delivering desalinated water through a Public Private Partnership and creating an enlarged water grid, are likely to require significant amendments to the existing governance arrangements if metropolitan water resources are to be managed effectively and efficiently.

In the current situation:

- Melbourne relies for its water supply on storages and network infrastructure controlled by Melbourne Water. Apart from a small proportion of recycled water, nearly all the water used is derived from rainfall and inflows into these water storages
- the prices paid by residential and commercial customers are based on Melbourne Water's and the retailers' costs of efficiently harvesting and delivering water
- Melbourne Water, the storage operator and operator of the bulk water supply infrastructure, makes the operational decisions on water releases from different storages
- these decisions are informed by an annual operating plan agreed, with the retailers, and constrained by other requirements (including the need for environmental flows, flood mitigation, minimum water quality standards and rationing bulk transfer capacity constraints during peak periods¹¹).

The decisions in the Victorian water plan will complicate the management of Melbourne's water resources:

- the decision to deliver the desalination plant through a Public Private Partnership (PPP) will place the responsibility for generating up to a third of Melbourne's annual water needs with a private entity.
- the contract between the State and the PPP consortium will set out obligations and arrangements which will help determine desalinated water supply levels and prices. The management of the expanded water grid will need to take account of these arrangements
- connecting the metropolitan water grid to Northern Victoria and Geelong provides the opportunity for water trading which did not previously exist
- the Government has relaxed its policy on banning water trades between Northern Victoria and Melbourne. Specifically the new North-South pipeline will be used to transfer up to 75 gigalitres of the water savings from the food bowl irrigation upgrade project in Northern Victoria.

¹¹ Victorian Competition and Efficiency Commission 2007, *Water Ways: Inquiry into Reform of the Metropolitan Retail Water Sector*, draft report, Victorian Competition and Efficiency Commission, Melbourne, section 8.1, p.172.

Having regard to the new supply sources and an expanded water grid, the governance arrangements need to be reviewed to optimise the operation of the metropolitan system.

‘Optimise’ here means managing the system to provide water security at least cost, with a fair allocation of these costs to beneficiaries within a clear policy framework (for example, where the Government wants to control how much water is traded between Northern Victoria and Melbourne).

The effective and efficient resolution of these issues requires an integrated approach

The connections between these issues mean that they cannot be addressed in isolation and require an integrated approach focussing on system-wide outcomes and costs.

5.4.6 This is particularly challenging given the need to meaningfully engage stakeholders and the wider community in determining these arrangements.

The Department has recognised the need to review and revise the arrangements for managing Melbourne’s water

The Department has formed an Integration Working Group to ‘coordinate the work necessary to amend the bulk water entitlements related to the expanded Central Region water grid as necessary to implement the decisions of the *Next Stage of the Government’s Water Plan*.¹²

The group includes representatives from: the water authorities in the Central Region affected by the Victorian water plan; DSE, DTF and DPC; and the desalination project within DSE’s Capital Projects Division.

The key deliverables of the group are:

- strategic advice on the future operation of the Melbourne water supply system as it relates to the expanded Victorian water grid
- a workplan to progress the short term issues needed for the desalination plant procurement
- a set of specifications describing how the Melbourne storages will be operated to optimise reliability of water supply and costs
- proposals to amend bulk water entitlements to incorporate the additional inflows to the system from the desalination plant and Sugarloaf pipeline
- proposals to allocate the costs of operating the Melbourne supply system to existing and new bulk entitlement holders.

¹² Department of Sustainability and Environment, Draft Terms of Reference—Integration Working Group.

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