



Management of Prison Accommodation Using Public Private Partnerships



VICTORIA

Victorian
Auditor-General

Management of Prison Accommodation Using Public Private Partnerships

Ordered to be printed

VICTORIAN
GOVERNMENT PRINTER
September 2010



This report has been produced to ISO14001 environmental standards. It is printed on FSC credited Novatech Satin & Media Print Silk paper. The print supplier, Blue Star PRINT has initiated an EMS promoting minimisation of environmental impact through the deployment of efficient technology, rigorous quality management procedures and a philosophy of reduce, re-use and recycle.



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

The Hon. Robert Smith MLC
President
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 performance report on *Management of Prison Accommodation Using Public Private Partnerships*.

Yours faithfully

A handwritten signature in black ink, appearing to read "D D R Pearson".

D D R PEARSON
Auditor-General

15 September 2010

Contents

Audit summary.....	vii
Background.....	vii
Conclusions	vii
Findings	viii
Recommendations.....	ix
Submissions and comments received	x
 1. Background	1
1.1 The prison system.....	1
1.2 The audit	3
 2. Service delivery outcomes	5
2.1 Introduction.....	6
2.2 Conclusions.....	8
2.3 Specifying service standards.....	8
2.4 Changing service standards.....	12
2.5 Monitoring and evaluating performance	14
2.6 Management of performance failures.....	17
 3. Contract administration	21
3.1 Introduction.....	22
3.2 Conclusions.....	22
3.3 Governance structure.....	22
3.4 Risk management	24
3.5 Managing contract amendments	25
3.6 Contract administration	27
3.7 Reporting to the Commissioner of Corrections	28
3.8 Whole-of-government support for the management of PPPs	29
 Appendix A. Prisons operating in Victoria	31
 Appendix B. Chronology of key events in the PPP contracts examined	33
 Appendix C. <i>Audit Act 1994</i> section 16—submissions and comments	35

Audit summary

Background

Since 1996, the private sector has become increasingly involved in owning, operating and managing prisons through public private partnerships (PPP). A PPP is a long-term partnership between the public and private sectors to deliver a major capital asset and/or services.

The Department of Justice (DOJ) manages several PPP contracts. When the Port Phillip Prison and Fulham Correctional Centre opened in 1997 the *Infrastructure Investment Policy for Victoria* (1994) applied. The Metropolitan Remand Centre and Marngoneet Correctional Centre contracts were signed in 2003 under a new policy adopted in 2001 called the *Partnerships Victoria Framework*. The new Ararat Prison contract was signed in 2010 under a later iteration of this framework, one that complies with the *Infrastructure Australia National Guidelines* (2008).

As two of these PPP prison contracts date back more than 10 years, it is timely to review the operational phase of such long-term contracts. This audit evaluated whether the state is managing PPP prison accommodation services well, whether the services are meeting appropriate standards and whether value-for-money and appropriate risk allocation has been maintained.

Conclusions

DOJ faces significant challenges in managing its long-term PPP prison contracts and recognises the need to further improve its management. Although it has been slow to act in relation to these challenges, DOJ has recently started implementing improvements and rectifying known deficiencies with its contract management and administration.

This is overdue as DOJ has not been able to demonstrate that it is continuing to receive value-for-money in terms of the standard of prison accommodation services it is paying for. Nor is it able to demonstrate that it has taken adequate steps to assure that the prison accommodation assets will be in an appropriate condition when ownership of the Port Phillip Prison and Fulham Correctional Centre assets reverts to the state.

All PPP contracts examined have weaknesses, particularly those developed pre-2001. They do not adequately define accommodation service standards, making it difficult for DOJ to effectively monitor contractor performance. For the post-2001 contracts, DOJ has not fully exercised its rights to monitor contractor performance and to manage service failures. There is insufficient documentation to explain the rationale for DOJ's approach, or the decisions made by contract administrators.

DOJ's administration of the PPP contracts can also be improved. It needs to demonstrate appropriate management of the risks allocated to the state to avoid a deterioration in the value-for-money premise on which the contracts were based. Recognising this, DOJ has recently commenced a review of its governance structure and to better document its contract management practices.

Findings

Service delivery outcomes

The pre-2001 contracts do not adequately specify accommodation service quality standards. This has limited DOJ's ability to reduce payments when contractors underperform.

For the post-2001 contracts, Metropolitan Remand Centre and Marngoneet Correctional Centre, DOJ has been reluctant to reduce service payments where service standards have not been met. Documentation in relation to the reductions in service payments applied is not sufficient to demonstrate that a rigorous analysis and thorough assessment has been undertaken to support these decisions.

Information from the contractor that is used to calculate monthly payments for the Metropolitan Remand Centre and Marngoneet Correctional Centre is not verified by DOJ. For Port Phillip Prison and Fulham Correctional Centre, DOJ has established an Annual Accommodation Service Review. However, the review does not establish a maintenance program and DOJ does not have the assurance that the assets are being appropriately maintained throughout the year. Without appropriate verification, monitoring and evaluation of contractor-supplied information, it is likely the state will receive the assets back in a poorer condition than expected.

DOJ has learnt from its earlier contracts and developed the Ararat Prison contract appropriately.

Contract management and administration

DOJ developed a complex governance structure for managing its PPP contracts. The current structure has multiple reporting lines and duplication of responsibility. DOJ has acknowledged this and recently decided to review and simplify the governance arrangements.

It is difficult for DOJ to demonstrate that contract variations and facility modifications have maintained value-for-money, because the decisions and contract variations have been poorly documented.

Shortfalls identified in DOJ's contract management systems include inadequate and missing contract administration manuals and risk management plans. These increase the risk that the state is not getting the services to the standard it pays for.

The Department of Treasury and Finance supports the procurement phase of PPP projects with considerable resources, however, the need for greater support to DOJ and other departments in the operational phase of these contracts is evident.

Recommendations

Number	Recommendation	Page
1.	The Department of Justice should: - analyse the potential costs and benefits of modifying its existing contracts to enhance its ability to extract services at the highest standard possible - independently audit key performance indicator data prepared by contractors - fully document its analysis of, and reasons for, decisions taken about time extensions to rectify faults and reductions in service payments.	20
2.	The Department of Justice should: - complete the review of governance structures and use a single contract administration unit to manage contracted prison services - complete contract administration manuals for each contract, including: - developing risk management plans - incorporating best practice from the <i>Partnerships Victoria Contract Management Guide</i> (2003) and the <i>Australian National PPP Policy and Guidelines</i> (2008), as applicable - document its analysis and rationale for all contract variations and facility modifications - maintain records of discussions at meetings with the Commissioner of Corrections to authorise contractor payments.	30
3.	The Department of Treasury and Finance should develop comprehensive guidance for the Department of Justice and other departments for the management of public private partnership projects at all stages of the contract.	30

Submissions and comments received

In addition to progressive engagement during the course of the audit, in accordance with section 16(3) of the *Audit Act 1994* a copy of this report, or relevant extracts from the report, was provided to the Department of Treasury and Finance and the Department of Justice with a request for submissions or comments.

Agency views have been considered in reaching our audit conclusions and are represented to the extent relevant and warranted in preparing this report. Their full section 16(3) submissions and comments, together with my acquittal response to the Secretary, Department of Justice, are included in Appendix C.

1 Background

1.1 The prison system

1.1.1 Introduction

The *Corrections Act 1986* (the Act) provides for the establishment, management and security of prisons, and the welfare of prisoners.

Corrections Victoria (CV), a business unit in the Department of Justice (DOJ), is responsible for administering the Act. It sets, monitors and reviews standards in all prisons, does business planning and initiates and coordinates the correctional infrastructure programs.

There are 14 prisons in rural and metropolitan locations, of which CV runs ten, providing all services. At two prisons, the Metropolitan Remand Centre and Marngoneet Correctional Centre, CV provides the correctional services and, using a public private partnership (PPP), the private sector provides accommodation services. DOJ delegates the monitoring and management of the accommodation services to Built Environment and Business Sustainability, a team in the Strategic Project and Planning Division of DOJ.

For the Port Phillip Prison and Fulham Correctional Centre, both of which opened in 1997, the private sector provides both correctional and accommodation services under a PPP. This is called a 'full service' model. CV monitors and manages the private sector provision of the correctional and accommodation services.

1.1.2 Policy framework for using the private sector to deliver services

Under a typical PPP, the private sector builds the asset and operates, maintains and refurbishes it for an agreed term, called the concession period. At the end of the concession period, asset ownership is transferred to the public sector.

When both Port Phillip Prison and Fulham Correctional Centre opened in 1997, the *Infrastructure Investment Policy for Victoria* (1994) and *Investment Evaluation Policy and Guidelines* (1995) applied which permitted the use of 'full service' contracts.

From 2001 government policy has been for the public sector workforce to provide 'core' services, such as correctional services. The Metropolitan Remand Centre and Marngoneet Correctional Centre opened in 2006.

DOJ's most recent PPP was the May 2010 contract to build an extension at the Ararat Prison and to run the prison's entire accommodation services. Ararat is the first social infrastructure project built since the release of the *Infrastructure Australia National Guidelines* (2008). These guidelines apply to PPP projects throughout Australia. The Commonwealth Government recommends that states and territories adopt them retroactively where applicable. The guidelines advise how to develop and manage a PPP, how to maintain long-term value-for-money, and how to manage these types of contracts.

1.1.3 Obtaining value-for-money

In its response to the Public Accounts and Estimates Committee *Report on private investment in public infrastructure 2006*, the government noted that value-for-money is driven by whole-of-life costing of one party's design and construction, service delivery, operating, maintenance and refurbishment costs.

The response also stated that concession terms needed to be long enough to effectively transfer whole-of-life risk, and that this generally meant 25 years or more. Its view was that shorter terms do not transfer whole-of-life risk and therefore reduce the chance of obtaining value-for-money.

Taking into account all options for extensions, all the contracts examined have terms of 25 years or more. On this basis, the premise is that value-for-money in PPPs would have been obtained through the initial competitive tendering process, as participants factored the ownership risks of long-term contracts into their bid prices.

However, this value-for-money premise is able to be tested during the concession period by comparing actual experience with intent. The most important factors to consider are whether the contracted services occurred, whether they met appropriate quality standards, and whether the costs reflected the level of service.

In practice this requires:

- measurable service standards for evaluating performance
- monitoring and evaluating actual performance
- adjusting service payments to reflect performance against standards.

1.2 The audit

1.2.1 Objective

The audit examined whether prison accommodation services contracted under PPPs are operating effectively and providing value-for-money. In particular the audit examined whether:

- accommodation service delivery outcomes have been met
- there is a performance management system that enables effective monitoring, managing and reporting
- negotiated changes to contracts maintain value-for-money and optimal risk allocation
- newer projects incorporate previous lessons learned.

1.2.2 Scope

The audit examined the accommodation services under the following contracts:

- Fulham Correctional Centre Prison Services Agreement (October 1995)
- Port Phillip Prison Services Agreement (July 1996)
- Metropolitan Remand Centre Facility Services Agreement (December 2003)
- Marngoneet Correctional Centre Facility Services Agreement (December 2003).

Figure 1A is a summary of these agreements.

Figure 1A
PPP prison arrangements

	Port Phillip Prison	Fulham Correctional Centre	Metropolitan Remand Centre	Marngoneet Correctional Centre
Year facility opened	1997	1997	2006	2006
Security rating	Maximum	Medium	Maximum	Medium
Capacity—initial	600	600	600	300
Capacity— as at 30 June 2010	804	845	663	306
Correctional services				
—initial concession period	5 years	3 years	n/a	n/a
—options for further concession period	5 x 3 years	5 x 3 years	n/a	n/a
Accommodation services				
—initial concession period	20 years	20 years	25 years	25 years
—optional concession period	10 years	20 years	n/a	n/a
Buildings				
Historic cost (\$mil)	65.169	62.048	163.459	81.124
Fair value 2009 (\$mil)	58.915	57.915	150.412	74.379

Note: The contractors would have been paid for their construction and debt servicing cost by the end of 2012 for Port Phillip Prison and 2017 for Fulham Correctional Centre.

Source: Victorian Auditor-General's Office, from original PPP contracts and Department of Justice information.

In negotiating further concession terms for Port Phillip Prison and Fulham Correctional Centre, the state has to take into account the existing lease arrangements on the two facilities. Currently, the contractors have a 40-year Crown lease over the relevant land for Port Phillip Prison and 50 years for Fulham Correctional Centre. These lease arrangements introduce complexity in determining when ownership of these assets reverts to the state.

The audit also reviewed the request for proposal and the proposed contract for the Ararat Prison extension.

The audit further examined the role of *Partnerships Victoria*, a team in the Commercial Division of the Department of Treasury and Finance, in overseeing the government's PPP policy.

1.2.3 Method

The audit was done in accordance with Australian Auditing and Assurance Standards.

1.2.4 Cost

The cost of the audit was \$530 000.

1.2.5 Structure of the report

The report is structured as follows:

- Part 2 examines the service delivery outcomes
- Part 3 examines the contract administration.

A summary of all prisons statistics and a chronology of key events in the PPP contracts examined are in Appendices A and B respectively.

2 Service delivery outcomes

At a glance

Background

In contracting out prison accommodation services through public private partnerships (PPP), the state seeks to obtain quality services and value-for-money. PPP contracts should identify who will deliver which services and to what standard. There should also be contractual flexibility to allow for both innovation and the likelihood that circumstances and government objectives will change during the contract term.

Conclusions

Weaknesses in the PPP contract provisions and shortcomings in the Department of Justice's (DOJ) contract management practices means that DOJ cannot be assured that it is receiving the accommodation services that it has paid for. These weaknesses and poor practices inhibit DOJ's ability to demonstrate whether the PPP contracts provide value-for-money for the state.

Findings

- The PPP contracts for Port Phillip Prison and Fulham Correctional Centre do not adequately define the quality standards for accommodation services.
- For some service failures, DOJ reduced service payments. This was not done consistently and there was inadequate documentation for most of these decisions.
- DOJ is not using contract provisions effectively to monitor and evaluate contractor performance.

Recommendation

The Department of Justice should:

- analyse the potential costs and benefits of modifying its existing contracts to enhance its ability to extract services at the highest standard possible
- independently audit key performance indicator data prepared by contractors
- fully document its analysis of, and reasons for, decisions taken about time extensions to rectify faults and reductions in service payments.

2.1 Introduction

2.1.1 Accommodation services contracts

The common feature of all four public private partnership (PPP) contracts is that the private sector runs the accommodation services in the facility that it built.

In providing accommodation services, each contract requires the private sector provider to comply with all relevant laws, be fit for purpose, adequately maintain the facility and make sure that services meet the standards set by Corrections Victoria (CV). Service standards relate to:

- accommodating a specified maximum number of prisoners
- repairing and maintaining the facility
- refurbishing the facility.

The private sector service provider must also comply with relevant policies, audit processes, prison management specifications in the contract, and the prison operating manual.

The provider is paid, generally monthly, for maintenance and for keeping the facility available for use over the concession period. This payment is referred to as the 'accommodation services charge' and pursuant to the contracts comprises:

- **a capital component**—to recover the building and funding costs
 - debt service payment
 - finance agency fees
- **an operating component**—to recover ownership costs, such as insurance, cleaning, waste disposal, repair and maintenance
 - reimbursement of rent payable
 - maintenance fee
 - insurance, statutory charges and administration costs.

Accommodation services are an important element of services delivered by the contractor. In the case of Port Phillip Prison and Fulham Correctional Centre, accommodation services are one component of the contract.

Figure 2A shows the percentage of the accommodation service charge for each of the operating contracts examined.

Figure 2A
2008–09 composition of service fee

Facility	Accommodation service charge (per cent)	Correctional service charge (per cent)
Port Phillip Prison	27.81	72.19
Fulham Correctional Centre	22.28	77.72
Metropolitan Remand Centre	100	Nil
Marngoneet Correctional Centre	100	Nil

Source: Victorian Auditor-General's Office, based on Department of Justice information.

Total expenditure for all contracted prison services in the facilities examined for the 2008–09 financial year was approximately \$143 million; of which approximately \$52 million related to accommodation service charges. For Port Phillip Prison and Fulham Correctional Centre, the total accommodation service charge for the same period was \$24.5 million. Of this, \$18.5 million related to debt service payment.

Each contract includes incentives that link fee payments to prescribed standards. The Department of Justice (DOJ) can apply reductions to service payments called abatements, where the services do not meet standards. The most common way of abating is to reduce the monthly fees.

Port Phillip Prison and Fulham Correctional Centre

The pre-2001 prison service agreements (PSA) for Fulham Correctional Centre and Port Phillip Prison have a monthly 'accommodation services charge' and 'correctional service charge'. The contract for Port Phillip Prison also includes a health services fee.

If the contractor meets the service standards in the PSAs, they may get an additional 'performance-linked fee' at the end of each year. In 2009, the maximum performance-linked fee as a proportion of the sum of the accommodation and correctional services fees was 1.6 per cent for Port Phillip Prison and 3.3 per cent for Fulham Correctional Centre. Thirty-five per cent of the performance-linked fee is payable for accommodation services and the balance for correctional services.

The contracts allow DOJ to reduce the accommodation services charge and the accommodation part of the performance-linked fee if the contractor has not provided the services to the standards specified in the contracts.

Metropolitan Remand Centre and Marngoneet Correctional Centre

The post-2001 facility service agreements (FSA) for the Metropolitan Remand Centre and the Marngoneet Correctional Centre have monthly fees for accommodation services. Where accommodation services are not provided as required, or where faults are not rectified within prescribed time limits, the fees may be reduced.

2.2 Conclusions

DOJ does not have sufficient assurance that it is receiving value-for-money in terms of the standard of accommodation services it is paying for. Nor is it able to demonstrate for the pre-2001 contracts that adequate steps have been taken to be reasonably assured the prison accommodation assets will be in an appropriate condition when ownership reverts to the state.

Weaknesses inherent in the pre-2001 contracts meant that DOJ could not effectively monitor the contractors' performance in relation to accommodation services. In particular, the PSAs for Port Phillip Prison and Fulham Correctional Centre do not adequately define the quality standards for the contracted accommodation services.

While the later PPP contracts for Metropolitan Remand Centre and Marngoneet Correctional Centre clearly define quality standards and performance expectations, the payment and abatement regime requires changing. To date DOJ has pursued this for the perimeter detection system only. In particular, DOJ recognises that some of the abatement amounts are not appropriate.

The available contractual provisions for monitoring and evaluating contractor performance are sound, but have been underutilised. In consequence, DOJ does not have the necessary level of assurance about performance.

Further, while DOJ has used its discretion to reduce service payments or not apply them in cases of performance failure, it had not adequately documented its reasons to support the majority of these decisions. It therefore cannot demonstrate that these decisions have not financially disadvantaged the state.

2.3 Specifying service standards

Past and current PPP policy frameworks require PPPs to have comprehensive performance measurement to assure the state that the contractors will meet minimum requirements. A compliant regime includes key performance indicators (KPI) that are specific, measurable and reportable, and which can be audited independently.

PPP contracts should clearly specify the contractor's responsibilities for services and the delivery standards so the state is confident it will get what it is paying for. Clear, unambiguous statements of requirements and service standards reduce the potential for disputes between the state and contractors. They also remove the need for contract administrators to use discretion to determine whether service standards are met, and to decide the consequence for failure.

The inadequate description of quality standards for accommodation services in the pre-2001 PSAs for Port Phillip Prison and Fulham Correctional Centre leave the service standards open to interpretation. It also means it has been difficult for DOJ to measure performance and reduce service payments.

The post-2001 FSAs for Metropolitan Remand Centre and Marngoneet Correctional Centre specify service delivery outcomes and performance expectations more clearly. However, the times allowed for correcting problems and the abatement amounts need to be changed.

Port Phillip Prison and Fulham Correctional Centre

The PSAs for Port Phillip Prison and Fulham Correctional Centre focus on correctional services outcomes, but also set out facility criteria for accommodation services.

For correctional services, there are 20 service delivery outcomes (SDO) across five categories in each agreement. However, not every SDO is relevant to each facility. The categories and examples of results for sub-categories are as follows:

- **prison operation**—the number of prisoner escapes, self-mutilations, assaults, positive drug tests
- **education and training**—the proportion of prisoners needing adult basic education or vocational training who are enrolled in and finish relevant programs
- **prison industries**—the number of skill areas for prisoners to take part in, proportion of sentenced prisoners taking part
- **health**—the proportion of prisoners medically screened within 24 hours of reception into the prison, number of valid complaints about health services to the Commissioner of Corrections
- **other programs**—their availability, the proportion of prisoners completing programs.

DOJ focuses on monitoring performance against the correctional services SDOs. It is argued that the contractors have an implied incentive to run accommodation facilities efficiently, so they meet the SDOs. This does not however diminish the need for DOJ to adequately monitor the standards for the accommodation facilities.

The PSAs also describe accommodation services and the requirement for their repair, maintenance and refurbishment. However, the contracts do not adequately specify quality standards. This means that quality standards are open to interpretation, making it difficult for the state to measure performance and reduce service payments.

This issue was identified in the October 2000 report commissioned by the Secretary of DOJ, *Independent Investigation into the Management and Operations of Victoria's Private Prisons*, which stated:

‘Moreover, many of the current output standards provide limited assistance in describing the level of service quality desired by the government. It appears that many of the standards could be met without providing any indication about the quality of that service.’

Figure 2B provides examples of poorly defined accommodation services for Port Phillip Prison, highlighting the quality standard elements that are not defined. The contract for Fulham Correctional Centre has similar specifications.

Figure 2B
Port Phillip Prison accommodation services requirements

Contractual requirement	VAGO assessment
The facility must accommodate prisoners predominantly in single cells.	'Predominantly accommodate' is not defined in the contract.
The contractor must keep the facility in good and substantial repair and condition.	'Good and substantial repair and condition' is not defined and neither is the time for faults to be rectified.
The contractor must keep the facility clean and free of rubbish, and store waste and garbage in proper receptacles.	The key words are not defined, and neither is the standard of cleanliness.
The contractor must refurbish the facility in line with the schedule annexed to the contract.	The contractor submitted the programmed maintenance schedule in its bid. It shows maintenance standards with five levels of response and reinstatement times but does not specify areas of the facility to which the standards apply. The schedule has not been updated or amended since inception. It is also largely illegible making it difficult to comprehend the detailed contractual maintenance obligations on the contractor.

Source: Victorian Auditor-General's Office.

The PSAs for Port Phillip Prison and Fulham Correctional Centre are silent on the standard of the facilities when they are returned to the state at the end of the concession period.

DOJ undertakes that the condition of Port Phillip Prison and Fulham Correctional Centre will be a key discussion point with the contractor in the next contract review for the facilities, currently scheduled for late 2010. DOJ believes that this will facilitate the return of the assets in an appropriate condition.

The PSAs include an option for the minister to request an extension to the facility term. In the case of Fulham Correctional Centre, this is 20 years, for Port Phillip Prison, it is 10 years. DOJ's view is that this option provides a strong incentive for the contractor to assure that the facilities are maintained appropriately.

However, we also note that the contractors would have recovered all capital and debt-servicing costs incurred for the initial construction of the facility by 2012 for Port Phillip Prison and 2017 for Fulham Correctional Centre, and therefore will have no debt service payments at risk from this time. This provides a reduced incentive for the contractor to maintain the quality of the buildings of the existing facility beyond this point.

Theoretically, the option to extend the concession term may be utilised by DOJ as leverage to encourage continued service delivery. However, there is no obligation on the part of the contractors to transfer the assets prior to the expiration of the Crown leases, which would be 2037 for Port Phillip Prison and 2047 for Fulham Correctional Centre.

This means that if the initial concession period is not extended, DOJ would require alternative accommodation facilities by 2017. This scenario, which is acknowledged by DOJ, raises the question whether the department has any real leverage to assure that the facilities are properly maintained.

Metropolitan Remand Centre and Marngoneet Correctional Centre

In contrast to the earlier contracts, the post-2001 FSAs for Metropolitan Remand Centre and Marngoneet Correctional Centre have more clearly specified services, measurable performance requirements and abatements for not meeting them.

The FSAs for these facilities contain provisions for the hand back of the assets to the state at the end of the concession period. The FSAs identify seven categories of service faults and the maximum allowable times for rectification. If the contractor fails to fix an identified fault within the permitted time, DOJ may reduce an amount up to six times the daily accommodation services charge for each event.

The FSAs also permit the state to grant a time extension, subject to the contractor using a state-approved temporary solution at their own cost. DOJ considers requests for extensions in light of the facility's continued operations and the contractor's ability to fix the issue on time.

Requests for extensions

DOJ advised that for the period 2006 to 2009, over 27 000 faults were logged at the Metropolitan Remand and Marngoneet Correctional Centres. The contractors requested 2 231 extensions of the rectification period and DOJ granted 1 951. The reasons for granting the extensions were not documented.

The number of extensions applied for and granted suggests that some of the allowable times in the FSAs are unrealistically short. For example, DOJ consistently grants extensions for light sealant rectification works due to work place health and safety requirements. However, if DOJ issued a contract administration note to extend the rectification period, this would remove the need to continually review and grant extensions for this event.

Calculation of abatement amounts

The FSAs define the amount of the allowable reduction in service payments, but in 78 per cent of service failure cases, DOJ reduced the payment by a smaller amount than allowed in the FSAs. In some cases, the reductions in service payments were significantly lower than those permitted.

DOJ advised that it considered that the amounts deducted from service payments were an appropriate reflection of the diminution in value of service the state had received. While DOJ has documents authorising the reduction in service payments, it has no records of how it calculated them nor any documented justification for them. DOJ explained that it was concerned that the contractor could become insolvent if it had to pay the full reduction in service payments for security and other major failures.

Ararat Prison

The Ararat Prison Project Agreement has clear, specific and measurable service requirements and quality standard KPIs. Figure 2C shows how service delivery requirements have changed over the last 14 years.

Figure 2C
Evolution of service delivery requirements in prison contracts

Port Phillip Prison 1996	Metropolitan Remand Centre 2003	Ararat Prison 2010
Prisoners to be predominantly accommodated in single cells.	80 per cent of cells must be single with the remaining mixed accommodation.	Two ground floor and universally accessible cells to each of the 76 bed units.
The contractor must keep the facility in good and substantial repair and condition.	The contract identifies 418 potential faults that the contractor must fix within eight hours or abatements apply.	The contract identifies 875 potential faults that the contractor must fix within eight hours or abatements apply. Point deductions against the overall bonus pool also occur.
The contractor must refurbish the facility in compliance with the refurbishment schedule.	The refurbishment schedule clearly identifies what projects need to be done monthly and annually.	The refurbishment schedule clearly identifies what projects need to be done monthly and annually. It also documents DOJ's checking procedures against quality standards.
The refurbishment schedule is Annexure P of the PSA. The Annexure P document is a photocopy which is illegible in some parts and too small to read in others.		

Source: Victorian Auditor-General's Office from the Port Phillip Prison Service Agreement, July 1996, Metropolitan Remand Centre Facility Service Agreement, 2003 and the Ararat Prison Project Agreement, 2010.

2.4 Changing service standards

The PPP contracts are all long-term, and payments for services are fixed for between 20 and 25 years, excluding potential contract extensions. All the prison PPP contracts allow DOJ to make minor changes to some service requirements and frameworks. However, the Port Phillip Prison and Fulham Correctional Centre PSAs do not permit significant changes to the accommodation services or performance standards. For the Metropolitan Remand Centre and the Marngoneet Correctional Centre, there are limited provisions that allow changes to security systems and services, such as cleaning and ground maintenance.

With the competitive pressures of tendering gone, the state is at a disadvantage if it wants changes. Any renegotiation of services or standards without the benefit of a competitive process risks erosion of the original value-for-money proposition.

Port Phillip Prison and Fulham Correctional Centre

The Port Phillip Prison and Fulham Correctional Centre PSAs allow changes to the correctional and facility services, but exclude modifying the accommodation service requirements or seeking to share cost savings from new technologies to accommodation services.

The state can re-tender for services like cleaning or rubbish removal but this must be linked to re-tendering for correctional services. Re-tendering correctional services would require appropriate restitution to existing contractors, thus most likely affecting value-for-money.

The October 2000 report commissioned by the Secretary recommended amendments to the PSAs and that the minister call for fresh tenders for running private prisons whenever there was the opportunity. DOJ should develop a list of amendments to the PSAs that would strengthen quality standards in relation to accommodation services should the opportunity to re-tender arise. DOJ would have an opportunity to include such amendments in negotiating any further accommodation service term.

DOJ has not acted on the recommendation in this October 2000 report. It has not actively assessed the possible cost consequences or service quality impacts of seeking to amend the contracts to better define quality standards for accommodation services. Nor has it analysed the potential cost or possible savings of re-tendering for correctional services.

Metropolitan Remand Centre and Marngoneet Correctional Centre

The FSAs permit limited changes to the scope and performance standards in relation to soft facility management services and security systems every seven years, at which time these services are repriced. In addition, for security system services, the state can elect at such time to provide these services itself or via a third party.

Under this process, the contractor must:

- use its best efforts to get three quotes from experienced and capable facility management providers for the service
- evaluate the quotes to confirm they provide value-for-money and competitive pricing and will not prevent the contractor from meeting the performance standards under the contract
- propose recommended revised pricing to DOJ.

This process has not happened, as the initial seven years are not yet up.

Ararat Prison

The Ararat Prison Project Agreement allows the facilities to change and for the contractor to save costs from new technology. It also allows re-pricing of services, and the review period has been cut from seven to five years. These improvements demonstrate that DOJ has taken heed of past contract weaknesses.

2.5 Monitoring and evaluating performance

An effective performance monitoring regime is risk-based, and adopts a combination of self-assessment with an appropriate level of independent verification of reported performance data. This is reflected in the *Partnerships Victoria Framework*, which states that contracts should require the contractor to provide an independent audit report of KPI data, and quarterly KPI reports on request. If such provisions do not exist, the framework indicates the government should request an audit of the KPI assessment or do its own.

Monitoring and evaluating service performance needs to be strengthened for all the prison contracts examined.

Port Phillip Prison and Fulham Correctional Centre

Because the PSAs do not adequately define the quality standards for accommodation services there is inherent uncertainty both for the contractors about maintenance and repair standards, and for DOJ in monitoring the services.

For these pre-2001 contracts, the contractor is not required to, and does not, report KPI information on accommodation services. The PSAs only require the contractor to keep sufficient data so that an audit trail can be established. The contract does not have provisions for independent audits of performance data. In response, DOJ introduced annual accommodation service reviews to assess the contractor's performance.

A three-person external review team normally conducts the review over a three-day period. DOJ's review methodology for this process includes:

- confirmation and evidence of maintenance and refurbishment procedures, including quality assurance, being carried out
- a visual inspection and recording of the relative condition of facility elements and components, buildings, mechanical and electrical services
- a review of maintenance testing, testing of the security systems
- an inspection of the facilities and grounds
- development and monitoring of an agreed action plan, including time frames for completion.

DOJ has consistently identified issues during its annual accommodation service reviews. However, the PSAs do not specify standards in relation to timely rectification of faults identified.

At the end of each service review, DOJ identifies a list of issues for the contractor to rectify. DOJ holds quarterly meetings with the contractor to review progress on the rectification of these issues.

This review focuses on whether the contractor has undertaken previously agreed maintenance and the current standard of the physical facility. While DOJ's methodology is comprehensive, there is a lack of evidence to demonstrate that the review addresses the need for regularly scheduled maintenance of the facilities throughout the year.

Metropolitan Remand Centre and Marngoneet Correctional Centre

The FSAs for Metropolitan Remand Centre and Marngoneet Correctional Centre allow for spot-checking and auditing of performance against the KPIs.

DOJ has implemented a series of monitoring mechanisms and the contract administration team has a contract monitor in place. A key aspect of this role is to assure data integrity and analysis in contract reports to satisfy the contract administrator and commissioner that these are accurate each month. Although there are a number of mechanisms and processes associated with monitoring contractor performance there is no evidence to demonstrate that all functions are performed.

Better quality evidence is required to determine whether the reported data is complete and accurate. DOJ has not audited the data or had it otherwise independently verified.

From time to time, the contractor has held local stakeholder feedback sessions, collated the results for review and forwarded them to DOJ. While feedback from facility users such as staff and prisoners can be useful to DOJ in understanding the contractor's performance, it does not replace the need to validate reported data.

Service standards in the FSAs include the time taken for the contractor to rectify faults. The rectification period starts from the time the contractor is notified of a fault. DOJ prison staff do not record the time that faults are reported to the contractor. Without this, it is not possible to verify whether notification times recorded by the contractor are accurate.

It is DOJ's view that internal audits by the contractor of its systems and processes provide assurance of data integrity. However, as DOJ has no direct relationship with the internal auditor, and receives no internal audit reports either from the contractor, or directly from its internal auditor, this is not a reasonable basis for assuring that data provided is accurate.

CV employees undertake formal and informal inspections including weekly site visits as well as quarterly and annual site inspections. DOJ recently provided documentation to show that identified faults are photographed and logged during these inspections. CV employees then coordinate with the contractor to rectify the faults identified. No evidence of such practice was found for the period 2006 to 2009.

Asset management plans

The FSAs for Metropolitan Remand Centre and Marngoneet Correctional Centre require the contractor to prepare an Asset Management Plan (AMP) for each prison and revise it each year. The contract administrator must give prior written approval to the contractors before any proposed amendments to the AMP are actioned.

The DOJ contract administrator identified a number of deficiencies in the 2009–2010 AMPs submitted by the contractor for approval. These include:

- the AMPs not describing the current condition of assets
- lack of commentary on under-performing assets, such as their level of reliability
- the AMP having no schedule of planned replacements and refurbishments for the coming year(s).

Prior AMPs also had these deficiencies. DOJ has the view that AMPs and monitoring their implementation take on greater importance from year five onwards. In recognition of this growing importance, DOJ has clarified with the contractor the appropriate standard of AMP the department considers reasonable to enable an assessment of the facility condition in the forward years. Detailed contract administration notes were provided to the contractors outlining this.

This approach did not take account of the importance of maintenance from the outset. During the warranty period, failure to appropriately maintain the asset could result in voiding the warranty. Whilst the contractors hold the asset condition risk, which includes breakdown and replacement costs, *Partnerships Victoria Contract Management Guide* provides guidance that service performance needs to be managed from the commencement of operations. Furthermore, some assets would have lifecycles of less than five years and would require maintenance during this time.

The absence of appropriate AMPs means that DOJ has had no reliable basis for assurance that appropriate maintenance had been undertaken or that the condition of these assets was maintained to contracted standards.

2.6 Management of performance failures

Failure to provide accommodation services to the required standards may lead to a cut in service payments.

For the pre-2001 contracts, DOJ has consistently identified performance failures in the accommodation facilities, yet has not applied reductions in service payments for the last 10 years.

For the post-2001 contracts, DOJ has a history of not exercising its full contractual rights to reduce service payments. It has not significantly reduced payments for, or resolved an issue about, the perimeter detection system, which has been outstanding since the start of operations.

Port Phillip Prison and Fulham Correctional Centre

Since 1999, DOJ has always paid the full accommodation service charges and the related performance-linked fees for Port Phillip Prison and Fulham Correctional Centre.

The annual accommodation service reviews have consistently identified service failures with accommodation services; however, DOJ has not reduced the service payments to the contractor. This has been due at least in part to the uncertainty brought about by the inadequate definition of quality standards in the contracts.

Metropolitan Remand Centre and Marngoneet Correctional Centre

Over the past five years, DOJ has sought to reduce the service payments to the contractor for the Metropolitan Remand Centre and the Marngoneet Correctional Centre for failing to meet standards 29 times. The contractor challenged 26 of these. In three instances, reductions in payments were subsequently reversed, one because of an arbitrator's decision. Of the remainder, 10 were resolved and 16 are outstanding. The total cost for the outstanding reductions in payments amounts to \$75 000. Figure 2D summarises these reductions.

Figure 2D
Total reduction in service payments applied over the past seven years

Reduction in service payments sought			Reduction in service payments agreed		
Number	Maximum allowed reduction ^(a)	Amount sought	Number	Maximum allowed reduction ^(a)	Amount applied
29	\$6 886 174	\$2 512 151	10	\$2 080 352	\$99 311

Note: (a) Maximum allowed abatements under the facility service agreements.

Source: Victorian Auditor-General's Office, based on schedule of abatements prepared by the Department of Justice and clauses in the facility service agreements.

The average reduction sought was \$89 720, or 36.5 per cent of the maximum possible reduction in service payment. However, the average reduction agreed was \$6 902, or 8.3 per cent of the maximum reduction in service payment, and significantly less than the allowable reduction.

Figure 2E gives examples of DOJ's management of individual reductions. These incidents show DOJ's different responses to service failures.

Figure 2E
Examples of Department of Justice management of reductions

Failure reason	Reduction allowed (\$)	Reduction sought (\$)	Reduction applied (\$)
Security failure – duress system	257 894	257 894	–
Failure to rectify fault in 'sally port' fire indicator panel within three day period	47 761	47 761	47 761
Various faults not fixed in time	399 735	86 711	20 000
Failure to fix identified issues during walk around	13 114	8 550	8 550
Failure to mend kitchen equipment	88 982	5 000	5 000
Perimeter detection system ^(a)	257 894	5 000	5 000

Note: (a) The contractor proposed the amount, which the Department of Justice accepted.

Source: Victorian Auditor-General's Office, based on schedule of abatements prepared by the Department of Justice and clauses in the facility service agreements.

DOJ has granted many time extensions over the past five years. Had it not granted them, additional reductions could have been applied.

Perimeter detection system benchmark review provisions

Under an agreement with the contractor, DOJ can establish what constitutes an acceptable level of false alarms to the perimeter detection system (PDS) during a benchmark review. This typically occurs during the first year of a PPP contract. However, despite the PDS failing from the first year of the contract, DOJ did not have a benchmark review until the fourth year of the agreement. Figure 2F is a case study of DOJ's management of this performance failure.

Figure 2F
Perimeter detection system abatements—
Metropolitan Remand Centre and Marngoneet Correctional Centre

In winning the PPP contract, the contractors assumed the PDS would generate a 'low' rate of nuisance alarms, with the benchmark to be agreed soon after operations began.

When designing the PDS the contractors failed to take into account the effect of adjoining land uses and environmental factors. The result was a much higher rate of nuisance alarms than expected.

The contractors have not suggested an acceptable rate of nuisance alarms to date. The false and nuisance alarms have been an ongoing problem at both facilities since they opened in 2006.

In 2008, the state engaged a consultant to report on acceptable alarm rate targets for the PDS. The report stated that these should be:

- Microwave – 10 alarms per week
- Microphonic – fewer than five alarms a week
- Taut wire – fewer than five alarms a week.

At the time of the 2008 report, the facilities had an average 643 alarms a week, mainly triggered by birds and litter.

During the 2009 benchmark review, DOJ applied abatements at a lower rate. The time given to rectify this problem has been extended four times. The PDS continues to trigger an unacceptably high rate of false alarms.

Due to the severity and persistence of the failure, DOJ could:

- apply abatements at 600 per cent of the daily service charge
- issue a notice of defect, which gives the contractor two months to fix it or a major default notification will be issued
- issue a major default notification that requires the failure to be fixed in two months or DOJ can terminate the contract.

DOJ has not done any of this but instead sought to reduce service payments every month for the past nine months. Six of the reductions were challenged by the contractor outside the contractual time frames. Therefore the reductions in service payment were maintained.

Source: Victorian Auditor-General's Office from information supplied by the Department of Justice.

Ararat Prison

The abatement amounts to be applied for failure to meet service requirements are significantly lower than those in the FSAs for Metropolitan Remand Centre and Marngoneet Correctional Centre. Figure 2G compares the lower and higher ranges for abatement amounts.

Figure 2G
Abatement amounts as a percentage
of the daily accommodation service charge

Contract	Lowest amount (per cent)	Highest amount (per cent)
Metropolitan Remand Centre	100	600
Marrngoneet Correctional Centre	100	600
Ararat Prison	2.5	100

Source: Metropolitan Remand Centre Facility Service Agreement, 2003, Marrngoneet Correctional Centre Facility Service Agreement, 2003 and the Ararat Prison Project Agreement, 2010.

According to DOJ, it has set the abatements for each prison at a level it considers 'a genuine pre-estimate of the diminished value to the state of the failure to provide all components of the services.' Clearly, over time DOJ has not only changed what it regards as the cost of under performance, but has also modified the abatement regime to allow better management of these agreements.

Further contractual improvements

The Ararat Prison Project Agreement includes requirements from the *Partnerships Victoria Framework* that are absent from the earlier prison PPP contracts, including:

- reducing service payments for late reporting
- extending the time for the state to make payments if the contractor is late with performance information
- reducing service payments for repeated faults of the same type
- reduce servicing payments for faults that are not fixed.

While it is clear that DOJ has applied the lessons from its previous contracts to the Ararat Prison Project Agreement, it now needs to focus on ways to overcome the weaknesses in its prior contracts and the associated shortcoming in performance monitoring.

Recommendation

1. The Department of Justice should:
 - analyse the potential costs and benefits of modifying its existing contracts to enhance its ability to extract services at the highest standard possible
 - independently audit key performance indicator data prepared by contractors
 - fully document its analysis of, and reasons for, decisions taken about time extensions to rectify faults and reductions in service payments.

3

Contract administration

At a glance

Background

The Department of Justice (DOJ) has two divisions managing contracted prison services; the Police, Emergency Service and Corrections Division manages Port Phillip Prison and Fulham Correctional Centre, while the Strategic Project and Planning Division manages Metropolitan Remand Centre and Marngoneet Correctional Centre.

Conclusions

DOJ's prison contract management systems have not been effective. It is not possible to demonstrate whether the state has received value-for-money from the contracts.

Findings

DOJ has:

- inadequate administration manuals and risk management plans
- not consistently documented its rationale for decisions when approving changes to the contracts.

Support to date from the Department of Treasury and Finance has focused mainly on the procurement phase of public private partnerships (PPP), and should be extended to the operating phase.

Recommendations

The Department of Justice should:

- complete the review of governance structures and use a single contract administration unit to manage contracted prison services
- complete contract administration manuals for each contract, including:
 - developing risk management plans
 - incorporating best practice from the *Partnerships Victoria Contract Management Guide* (2003) and the *Australian National PPP Policy and Guidelines* (2008), as applicable
- document its analysis and rationale for all contract variations and facility modifications
- maintain records of discussions at meetings with the Commissioner of Corrections to authorise contractor payments.

The Department of Treasury and Finance should develop comprehensive guidance for the Department of Justice and other departments for the management of public private partnership projects at all stages of the contract.

3.1 Introduction

Effective contract management helps the state get value-for-money and the results it is seeking. Work on the contract management strategy needs to start early in the procurement process so that all the state's requirements are in the draft contract. In particular, the draft contract needs to include an effective performance monitoring system that describes the contractor's reporting obligations. The Department of Justice (DOJ) is responsible for the preparation of the contract management strategies and systems for the public private partnership (PPP) prison contracts.

Service and standard requirements can change during long-term contracts, which may last 20 or more years. Contracts and contract management need to be flexible enough to allow contractors to adapt. Partnerships Victoria (PV), a team in the Commercial Division of the Department of Treasury and Finance (DTF) has published guidelines on how to manage long-term contracts effectively and how to deal with change.

3.2 Conclusions

Shortcomings in the management and administration of the prison accommodation services contracts by DOJ mean it is not possible to demonstrate whether the state has received value-for-money.

DOJ has used an overly complex contract governance structure for the pre- and post-2001 contracts with multiple reporting lines and duplication of responsibility. DOJ has however now decided to review and simplify this governance structure.

DOJ's contract management systems are inadequate and contract administration manuals and risk management plans are missing. In addition, DOJ has poorly documented its decisions and contract variations. The complexity of these systems inhibits the states ability to obtain value-for-money from these contracts.

It has been slow to act in these respects, both to identify and to address these issues, but has recently taken action, and is planning further action, to remedy the situation.

Support from DTF has been primarily focused on the procurement phase. There is limited evidence that support has been provided during later stages of these contracts. DTF should offer more support to the departments that manage PPP contracts.

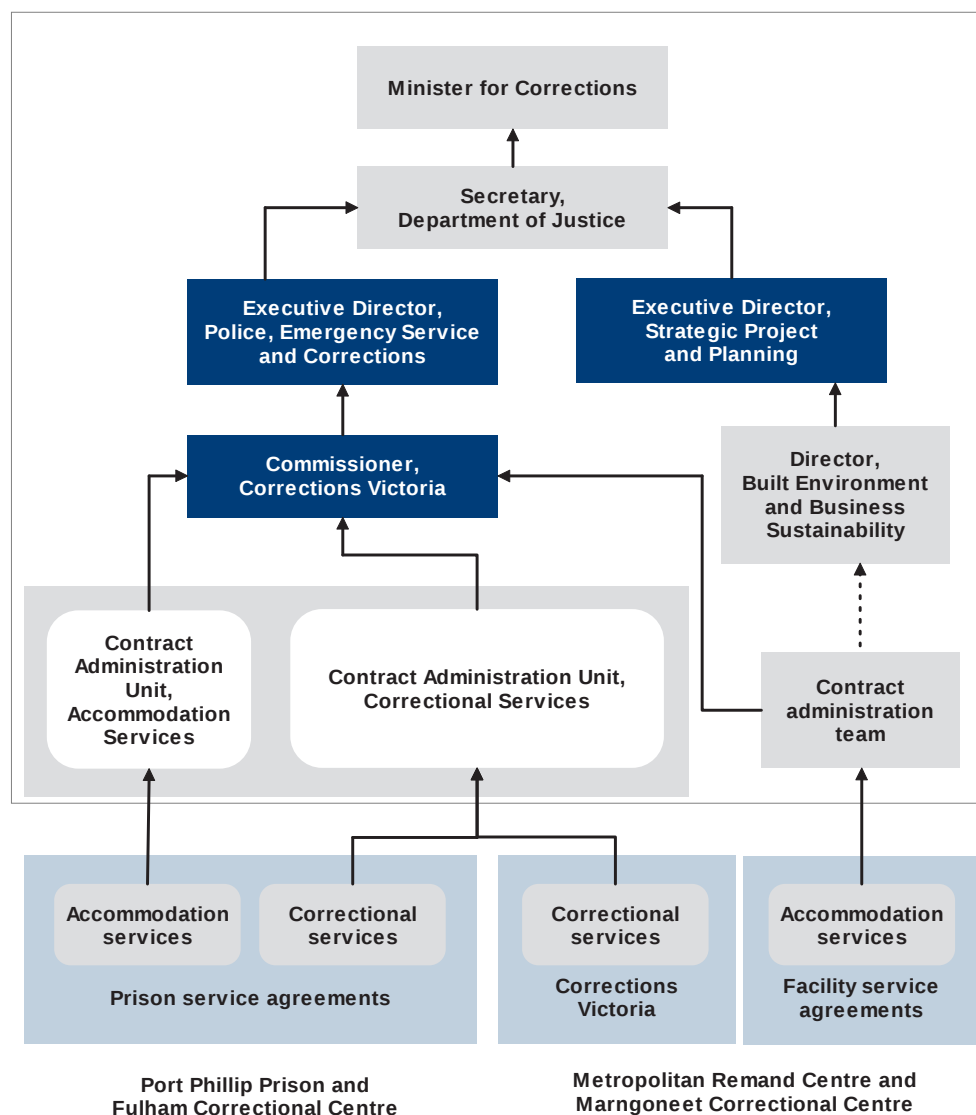
3.3 Governance structure

A good contract governance structure should have sound communication between all parties for seamless services and efficient contract management.

DOJ's contract management structure is overly complex and divides the management of contracts between different divisions in the department.

Figure 3A summarises DOJ's governance structure for the PPP prisons.

Figure 3A
Department of Justice governance structure



Source: Victorian Auditor-General's Office.

Port Phillip Prison and Fulham Correctional Centre

The contractors for Port Phillip Prison and Fulham Correctional Centre are responsible for correctional and accommodation services. However separate divisions within DOJ manage the different services.

Metropolitan Remand Centre and Marngoneet Correctional Centre

The contractors for the Metropolitan Remand Centre and Marngoneet Correctional Centre run accommodation services, while Corrections Victoria is responsible for correctional services.

Again, separate DOJ divisions manage the accommodation and correctional services. However, the division that manages accommodation services for Port Phillip Prison and Fulham Correctional Centre is different from the one managing the Metropolitan Remand Centre and Marngoneet Correctional Centre.

Changes being implemented by DOJ

During the audit, DOJ advised it was reviewing Corrections Victoria's governance structure. DOJ envisages that a single contract administration unit will become responsible for the prison PPP contracts that are the subject of this report.

3.4 Risk management

The identification, assessment and management of risk are key to a successful contract management system. The allocation of risks during the concession term should remain consistent with the provisions of each contract and not shift to the state inappropriately.

DOJ has no risk management plans for the four PPP prisons. As a result, it is not possible to reliably assess whether the risks to the state are being managed effectively. DOJ has commenced documenting risk management plans as part of the updating of the contract administration manual.

Port Phillip Prison and Fulham Correctional Centre

DOJ has no risk management plans for these prison service agreements (PSA). It should prepare plans that identify the risks to the state, and strategies to manage and mitigate them.

DOJ believes that the contractors are adequately managing risks allocated to them and that mechanisms are in place to ensure this is the case. However, the absence of appropriate risk management plans for these PSAs brings into question how well state risk is being managed.

Metropolitan Remand Centre and Marngoneet Correctional Centre

DOJ developed a thorough risk management methodology for the Metropolitan Remand Centre and Marngoneet Correctional Centre. However, the methodology has not been used in the past five years and DOJ has yet to prepare risk management plans.

3.5 Managing contract amendments

In comparison to the procurement phase there is less competitive pressure on the contractors when negotiating prices for proposed accommodation modifications during the life of the contract. Thus the state must find some other way to establish that it has maintained value-for-money when increased costs or reduced service levels arise from contract amendments.

During the concession terms for the PPP prison contracts modifications to each of the facilities have been made and increases in accommodation service payments have occurred. For the modifications examined by audit there is little documentation of how DOJ verified costs proposed by contractors. This made it difficult to determine whether the state has obtained value-for-money and whether risk allocation has been appropriate.

A chronology of key events in the examined PPP contracts is included in Appendix B, which shows all the variations to the contracts.

Port Phillip Prison and Fulham Correctional Centre

Deeds of variation

There have been two variations in the Port Phillip Prison contract, one in 2002 and the other in 2010. These were for the expansion of the facility to enable more prisoners to be accommodated and included an increase in the accommodation services fee for the associated work.

DOJ documentation and assessment for the 2002 variation was consistent with policy and the PSA. However, the 2010 variation does not demonstrate how the state has evaluated the ongoing costs to assure that they represent value-for-money. In addition, there is no evidence of risk assessment included on the files.

There have been two variations to the Fulham Correctional Centre contract for new buildings and changes to accommodation services. DOJ has no documentation on one of the variations, its evaluation of costs, risk assessment or benefit to the state. For the other variation, there is no evaluation of the ongoing costs to assure that it represents value-for-money, or whether there is a potential risk transfer to the state.

DOJ is therefore unable to demonstrate that the variations to the facility and services gave value-for-money or that contract risks were not inadvertently or inappropriately transferred to the state.

Modifications to facilities and services

Modifications, such as changing floor surfaces to carpet tiles, are able to be proposed by either the state or the private sector contractor. The modification process, including its evaluation is set out in each of the PSAs. The PSA requires an evaluation of proposed modifications to include potential cost of the variation to the state, impact on contractor profit, and effect on other services.

The audit examined a sample of 16 representative modifications made to Port Phillip Prison and Fulham Correctional Centre. There were no quotes, detailed statements of scope or other supporting documents for 11 of the 16 examined. There was no evidence that DOJ considered whether the modifications would transfer risk to the state or were value-for-money.

No evidence was provided during the audit conduct of what, if any, consideration was given to the value-for-money of one significant facility modification at Port Phillip Prison which resulted in recurrent annual maintenance/repair costs of \$173 012 for a new accommodation unit. DOJ recently provided a value-for-money assessment of this modification. However, this analysis was not included in the modification documentation provided to the commissioner for authorisation.

Metropolitan Remand Centre and Marngoneet Correctional Centre

Deeds of variation—energy costs

There have been deeds of variation to the Metropolitan Remand Centre and Marngoneet Correctional Centre contracts, each for energy costs. The variations were made after the contracts were signed in December 2003 but prior to the contractor's financing arrangements being finalised, referred to as 'financial close'.

The deeds to vary who paid for energy costs were signed when the tender process had ceased and there was no competition from other bidders. At this point, the state's options were limited to either accepting the risk transfer or terminating the contract.

The deeds provided that the state would pay the actual cost of energy. At certain points in this period, the state, in agreement with the contractor, could revisit annual energy costs and fix them based on the actual cost incurred to date. As such, by entering into the deeds, the state took back the risk of energy costs for the first seven years but did not receive any compensation.

Before accepting the risk, DOJ did not update its tender evaluation for the increased cost of this proposal to the state, to determine whether this proposal still represented the best value for the state.

In 2008, the state reviewed this arrangement and decided to continue to pay the energy costs for both facilities. The state has another opportunity to review this in 2013.

In reviewing this requested variation a DOJ committee was concerned that the matter, if not resolved, could have made the project unviable. However, there is no evidence that the committee evaluated:

- the potential cost to the state
- whether the cost proposed by the contractor was accurate
- whether no variation would affect the contractor's viability.

The ministerial brief said that not making this variation could 'drastically reduce' the contractor's profit. However, the brief did not note the costs to the state or future risk that the state was assuming. The brief also omitted the results of the DOJ committee's review.

Modifications to facilities and services

The audit reviewed a representative selection of 16 modifications at the Metropolitan Remand Centre and Marnngoneet Correctional Centre. There is no evidence that DOJ evaluated the contractor's proposals or considered the benefits or costs of any of them. In six cases, the contractor gave only one quote, which breaches DOJ policy that requires a minimum of three quotes for this level of expenditure.

In only four of the 16 cases examined, records show that the DOJ contract management team considered the benefits of improvements, had external advisors review costs and received more than one quote from the contractor.

3.6 Contract administration

Properly prepared and authorised administration manuals support effective contract management and, in the event of changes in departmental staff, allow management to continue.

Recognising the importance of contract administration manuals, DTF prepared the *Partnerships Victoria Contract Management Guide 2003*. The guide requires an agency to write a contract management plan and a detailed contract administration manual for each PPP contract they are managing for the state. The plan and manual should cover the design, building and operation phases of projects.

DOJ had not prepared contract administration manuals for the pre-2001 contracts and the post-2001 contract administration manuals do not comply with the requirements of the DTF guide.

Port Phillip Prison and Fulham Correctional Centre

DOJ has not prepared contract administration manuals for the Port Philip and Fulham Correctional Centre PSAs. While these PSAs were signed before the guide was published, contract administration manuals would be beneficial.

DOJ has recently advised that it has started drafting contract administration manuals for these PSAs.

Metropolitan Remand Centre and Marngoneet Correctional Centre

DOJ has contract administration manuals for the Metropolitan Remand Centre and Marngoneet Correctional Centre contracts, but they do not comply with the guide requirements. As an example, the guide requires agencies to document how they will assure performance reporting data is accurate and what constitutes their monitoring regime. DOJ's manuals do not have any statements regarding performance reporting and monitoring but rather provides a summary of the requirements in the contract.

Figure 3B evaluates compliance.

Figure 3B
Contract administration manual compliance

Policy requirement	DOJ manuals coverage
Contract administration	Partially compliant
Performance reporting and monitoring	Not compliant
Relationship and issue management	Fully compliant
Dispute resolution	Partially compliant
Governance, probity and compliance	Partially compliant
Knowledge and information management	Not compliant
Change management	Not compliant
Contingency planning	Not compliant
Ongoing review	Not compliant

Source: Victorian Auditor-General's Office assessment based on Department of Justice information and the *Contract Management Manual* issued by the Department of Treasury and Finance.

DOJ recently engaged a consultant to amend the manuals in accordance with the guide.

3.7 Reporting to the Commissioner of Corrections

Under both the PSAs and facility service agreements, the Minister of Corrections should receive monthly reports from the contractors before performance payments are approved. The Commissioner of Corrections is delegated to receive contractor reports and authorise monthly and annual incentive performance payments for each contract.

Reporting to the commissioner is inconsistent across the contracts. The reports to the commissioner do not contain sufficient information to determine whether the proposed payment is appropriate.

Port Phillip Prison and Fulham Correctional Centre

The contractors for the Port Phillip Prison and Fulham Correctional Centre are entitled to be paid monthly for their services and also may receive an annual performance payment.

The PSAs require the contractor to report to the commissioner monthly on services, and to advise the contract administrator of any material defects, damage or repairs and key issues, such as accommodation shortages. Although the contractor reports monthly to the contract administrator, in practice the commissioner was not provided with this report.

The commissioner meets with the DOJ's contract administrator monthly to discuss the contractor's performance and the calculation of the monthly payment. DOJ does not provide the commissioner with a written report. The commissioner authorises the payment to the contractor at these meetings. Minutes of these meetings are not kept.

Metropolitan Remand Centre and Marngoneet Correctional Centre

The contract administrator and contractor provide the commissioner a monthly report about the Metropolitan Remand Centre and Marngoneet Correctional Centre contracts when seeking approval to pay the monthly services charge.

However, the reports do not cover all areas specified in the *Partnerships Victoria Contract Management Guide*. For example they do not include:

- time extensions granted by the contract administrator
- explanations of what, if any, penalties have been applied
- the progress of agreed modifications to the facility.

The commissioner meets with DOJ's contract administrator monthly to discuss the reports. The commissioner then authorises the payment to the contractor, however minutes of these meetings are not kept. A quarterly meeting between the state and the contractor is held to review the monthly reports. Records of these quarterly meetings are documented.

Documentation had recently been provided to show that DOJ and the contractor have begun to include additional data to strengthen the quality of reports submitted to the commissioner.

3.8 Whole-of-government support for the management of PPPs

DTF provides significant support to government departments on PPP projects. It has policies and frameworks to support the procurement and contract management phases of these projects. In particular, Partnerships Victoria policy states that DTF will:

- support and review the contract management of PV projects, including helping with risk mitigation and dispute resolution
- help share contract management knowledge, including holding forums for contract managers to share lessons and network with peers
- establish and run training for public sector contract directors and managers
- monitor and independently advise the Treasurer and Cabinet on significant contract management issues.

DTF staff have supported DOJ to manage the PPP prison contracts by providing training and contract management knowledge through regular discussions at key points and facilitating a whole-of-government contract management forum. In addition, DTF staff were in the project team that developed the expression of interest, request for proposal and evaluation process for Ararat Prison.

DTF's support to date to DOJ has been focused mainly on the procurement phase of PPP projects. Given the findings in this audit, it is evident further assistance to departments to manage PPP projects in their operating phase is warranted by:

- developing and providing contract administration tools, such as plans and example manuals
- researching best practices throughout Australia and overseas and distributing this to Victorian PPP contract managers
- giving greater hands-on guidance for those projects in the operating phase.

DTF advised that it is investigating how, during the operating phase of PPPs, improvements can be implemented in order for Victoria to retain its leadership in this field.

Recommendations

2. The Department of Justice should:
 - complete the review of governance structures and use a single contract administration unit to manage contracted prison services
 - complete contract administration manuals for each contract, including:
 - developing risk management plans
 - incorporating best practice from the *Partnerships Victoria Contract Management Guide* (2003) and the *Australian National PPP Policy and Guidelines* (2008), as applicable
 - document its analysis and rationale for all contract variations and facility modifications
 - maintain records of discussions at meetings with the Commissioner of Corrections to authorise contractor payments.
 3. The Department of Treasury and Finance should develop comprehensive guidance for the Department of Justice and other departments for the management of public private partnership projects at all stages of the contract.
-

Appendix A.

Prisons operating in Victoria

Prison	Description	Security level	Operating capacity at 30 June 2010	Operator
Ararat Prison	Ararat Prison was opened in 1967, replacing the century-old Ballarat Goal. Ararat Prison is located 200km west of Melbourne.	Medium	382	Corrections Victoria
Barwon Prison	Barwon Prison provides accommodation and services for mainstream, maximum security prisoners.	Maximum	425	Corrections Victoria
Beechworth Correctional Centre	Beechworth Correctional Centre focuses on reparation and pre-release activities—helping prisoners reintegrate into the community when they are released.	Minimum	120	Corrections Victoria
Dame Phyllis Frost Centre	The Dame Phyllis Frost Centre provides maximum security, medium security and specialist accommodation for remanded and sentenced women prisoners.	Maximum	260	Corrections Victoria
Dhurringile Prison	Dhurringile Prison is a pre-release prison where prisoners undertake both on-site employment and meaningful community reparation via community assistance programs.	Minimum	214	Corrections Victoria
Fulham Correctional Centre	Fulham Correctional Centre accommodates predominantly mainstream prisoners and includes a drug and alcohol treatment unit and a protection unit.	Medium	845	Private provider—full service
Judy Lazarus Transition Centre	The centre provides a supervised pathway back into society for selected prisoners nearing the end of their sentence. It is named after Judy Lazarus, a prominent advocate of prisoner resettlement and former CEO of the Victorian Association for the Care and Resettlement of Offenders.	Minimum	25	Corrections Victoria

Prison	Description	Security level	Operating capacity at 30 June 2010	Operator
Langi Kal Kal	Langi Kal Kal is located on a large working farm. The prison accommodates 110 minimum security prisoners with low to medium protection requirements, and operates as a minimum security pathway for protection prisoners from Ararat Prison.	Minimum	122	Corrections Victoria
Loddon Prison	Loddon Prison is a mainstream prison focusing on release preparation and drug rehabilitation. It also offers placement and support for HIV-positive prisoners and release preparation for intellectually disabled prisoners.	Medium	410	Corrections Victoria
Marngoneet Correctional Centre	The Marngoneet Correctional Centre provides intensive treatment and offender management programs for males who are at moderate to high risk of re-offending, and who have a minimum of six months of their sentence left to serve when they arrive there.	Medium	306	Corrections Victoria provides correctional services while private provider is responsible for accommodation services
Melbourne Assessment Prison	Melbourne Assessment Prison facility provides statewide assessment and orientation services for all male prisoners received into the prison system.	Maximum	286	Corrections Victoria
Metropolitan Remand Centre	Metropolitan Remand Centre is Victoria's major remand facility for un-sentenced male prisoners. The facility makes it possible to separate sentenced and un-sentenced prisoners, so far as practicable.	Maximum	663	Corrections Victoria provides correctional services while private provider is responsible for accommodation services
Port Phillip Prison	The facility provides remand, sentenced, mainstream, protection and specialist accommodation for high, maximum and medium security prisoners. Port Phillip Prison was the third privately operated prison to open in Victoria.	Maximum	804	Private provider—full service
Tarrengower Prison	Prison Tarrengower is a minimum security women's prison with an emphasis on release preparation and community integration.	Minimum	54	Corrections Victoria

Note: Public private partnerships are highlighted in bold.

Source: Department of Justice.

Appendix B.

Chronology of key events in the PPP contracts examined

Port Phillip Prison

Date	Event
July 1996	Contract signed
August 1996	Construction commences
August 1997	Begins operations
September 1997	Receives first prisoner
March 2002	Contract amended by deed of variation to increase capacity
June 2003	Contract renewal and variation of prison service agreement (PSA)
June 2008	Contract renewal and variation of PSA
June 2010	Contract amended by deed of variation to increase capacity

Source: Department of Justice documents.

Fulham Correctional Centre

Date	Event
October 1995	Contract signed
November 1995	Construction commences
March 1996	Begins operations
April 1997	Receives first prisoner
September 2002	Contract amended by deed of variation to increase capacity
September 2003	Contract renewal and variation of PSA
June 2008	Contract amended by deed of variation to increase capacity
September 2008	Contract renewal and variation of PSA

Source: Department of Justice documents.

Metropolitan Remand Centre

Date	Event
December 2003	Contract signed
January 2004	Construction commences
April 2006	Begins operations
May 2006	Receives first prisoner

Source: Department of Justice documents.

Marngoneet Correctional Centre

Date	Event
December 2003	Contract signed
January 2004	Construction commences
March 2006	Begins operations
April 2006	Receives first prisoner

Source: Department of Justice documents.

Appendix C.

Audit Act 1994 section 16— submissions and comments

Introduction

In accordance with section 16(3) of the *Audit Act 1994* a copy of this report was provided to the Department of Treasury and Finance and the Department of Justice with a request for submissions or comments.

The submissions and comments provided are not subject to audit nor the evidentiary standards required to reach an audit conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with the agency head.

Contents

- Submissions and comments received:36
 - Department of Treasury and Finance.....36
 - Department of Justice39
- Auditor-General's acquittal response to the Secretary, Department of Justice44

Submissions and comments received

RESPONSE provided by the Secretary, Department of Treasury and Finance



Department of Treasury and Finance

1 Treasury Place
GPO Box 4379QQ
Melbourne Victoria 3001
Telephone: (03) 9651 5111
Facsimile: (03) 9651 5298
DX 210759

Mr Des Pearson
Auditor-General
Victorian Auditor-General's Office
Level 24
35 Collins Street
Melbourne VIC 3000

Our Ref:
F08 / 3930

Dear Mr Pearson

Re: Management of Prison Accommodation Using Public Private Partnerships

Thank you for your letter of 18 August 2010, and for the enclosed copy of the Audit Report on Public Private Partnership (PPP) prisons.

Previous copies of the Audit Report have now been replaced with a re-issued report delivered to Treasury (by hand) on 6 September 2010.

As a result of the latest dialogue between Treasury and Audit, the extent of differences in opinion and/or interpretation have been narrowed in the 6 September edition of the Audit Report. Treasury welcomes the convergence of views.

The previous Treasury reply (and attached formal comments) dated 31 August are now rescinded and replaced with a shorter DTF commentary. The residual issues that continue to be of concern to Treasury are summarised in the attachment to this letter.

Consistent with your earlier advice, a copy of the Treasury reply has been emailed to Dallas Mischkulnig.

Thank you for the opportunity for full participation in the audit, which stimulated a timely re-examination of some Treasury practices, especially the extent of Treasury effort committed to "downstream" contract management as distinct from "upstream" contract signing.

If you require clarifications or further information please contact Jim Ferguson at DTF on 9 651 5475.

Yours sincerely

Grant Hehir
Secretary



**RESPONSE provided by the Secretary, Department of Treasury and Finance –
continued**

DTF response to the Victorian Auditor General's Report
[Version dated 06.09.2010]

**Management of Prison Accommodation Using Public Private
Partnerships**
September 2010

Hand-back

[VAGO Conclusions -page vii; Findings page viii; Conclusions para one, page 7]

VAGO has reported that DoJ is not able to demonstrate that ... "for the pre 2001 contracts that adequate steps have been taken to be reasonably assured that the prison accommodation assets will be in an appropriate condition when their ownership reverts to the State".

DTF acknowledges the importance of asset condition, and its influence on functionality. Asset condition, or more specifically residual value, becomes more important as the point of "hand-back" approaches.

However, with respect to network capacity requirements, the Government has options for balancing supply and demand in the longer term (on a system wide basis). Specifically regarding the pre 2001 PPP contracts (Port Phillip and Fulham), these contracts do not expire until 2017, and the Government will continue to review its options over the next seven years. DTF notes that unlike modern PPP contracts, there is no automatic reversion to the State under the pre 2001 contracts.

Benefit – Cost Analysis of changing existing contracts

[VAGO page viii, and page 21]

VAGO recommendation No. 1.1

"DoJ should analyse the potential costs and benefits of modifying its existing contracts to enhance its ability to extract services at the highest standard possible."

DTF supports cost-benefit analysis of proposed contract changes under the following circumstances:

- (a) Contract performance is clearly unsatisfactory eg Default Notice issued;
- (b) Prior to approaching the service provider for a Change Notice in respect of a major State initiated modification;
- (c) Towards the end of contract term (to inform roll-over decisions).

Beyond those circumstances, continual analysis of the costs and benefits of changing a PPP contract is unlikely to have a positive net present value, and may adversely impact on the relationship with the counter-party.

**RESPONSE provided by the Secretary, Department of Treasury and Finance –
continued**

**DTF assistance to Departments to manage PPP projects in the operating
phase**

[VAGO page ix, and page 31]

VAGO recommendation No.3

“DTF should develop comprehensive guidance, for the Department of Justice and other departments, for the contract management of PPP projects during the operating phase”.

DTF agrees with the need to continuously review its guidance to departments so as to ensure the material remains comprehensive, but acknowledges that more central agency assistance to line agencies would be desirable during the operating phase.

Deeds of Variation – Energy Costs

[VAGO page 27]

VAGO has noted a Deed of Variation regarding energy costs on the Marngoneet and MRC contracts just before financial close.

DTF contends that the Deed did not vary “who paid for energy costs”.
Rather the State varied the extent of energy volume risk transfer.

DTF notes that the project tender documents went to the market on the basis of the State carrying price risk but the private party taking volume risk, and that is still the case (but there is now an agreement to review volumes at year 7 of operations ie 2012/13). Until then, the actual payments / cost to the State are as per prior to the Deed.

DTF 08 September 2010

RESPONSE provided by the Secretary, Department of Justice



Department of Justice

Secretary

121 Exhibition Street
Melbourne, Victoria 3000
GPO Box 4356QQ
Melbourne, Victoria 3001
Telephone: (03) 8684 0500
Facsimile: (03) 8684 0525
penny.armytage@justice.vic.gov.au
DX 210077

Our Ref: CD/10/366858

Mr D D R Pearson
Auditor-General
Level 24, 35 Collins St
MELBOURNE VIC 3000

Dear Mr Pearson

PROPOSED AUDIT REPORT: MANAGEMENT OF PRISON ACCOMMODATION SERVICES USING PUBLIC PRIVATE PARTNERSHIPS

Thank you for your letter of 18 August 2010 enclosing your proposed report into the *Management of Prison Accommodation Services using Public Private Partnerships*, and for your invitation to provide formal comments for inclusion in the report.

I am aware that there has continued to be close contact among staff of our respective agencies in relation to the various drafts of the report that have been provided, and I appreciate the efforts of your Office to understand this Department's ongoing concerns.

Following my initial response of 1 September 2010, to a revised version of your report delivered to the Department of Justice (DOJ) on 27 August, I am now providing amended comments in relation to the subsequent revision delivered to Mr Tony Leech, Executive Director, Police Emergency Services and Corrections, on 6 September. I am advised that this incorporates further significant changes from the versions provided on 18 and 27 August, as a result of feedback from staff of DOJ and the Department of Treasury and Finance. I am pleased that the latest version renders some of my previous observations redundant.

As previously indicated, I welcome the independent assessment by your Office (VAGO) of this component of Victoria's prison system, and I accept that such external analyses are an important tool in our efforts to continuously improve our management practices. The audit process itself is valuable in holding departmental decision-making, record-keeping and contract management arrangements up to light, all of which has the potential to provide lasting benefits. I would also acknowledge that, as a result of this process, DOJ has initiated some changes to its contract management practices and its administration of prison public private partnerships (PPPs).



RESPONSE provided by the Secretary, Department of Justice – continued

However, it remains important to highlight some of the areas of concern to DOJ that the audit has left unresolved. I have included comments to this effect as an attachment and then offer some specific responses to the individual recommendations.

As a general observation, my view is that the VAGO report still fails to provide a fair representation of how prison accommodation services are managed across the PPPs, despite detailed feedback from this Department, both in writing and in person. In particular, the report fails to recognise a number of the key contextual issues impacting upon the prison accommodation services contracts which form the subject of the audit.

There still appears to be some inconsistency between the rigour expected of the Department in adducing evidence to support its contentions during the audit process, and the standards that appear to apply to the assumptions and statements of opinion appearing in the report, which are in key instances unfounded.

Finally, I am mindful of the apparent conflict between the broad tenor of the report's recommendations and the commentary in the body of the report, which has a decidedly more critical thrust. Those recommendations in the report which are addressed to the Department, considered in isolation, are broadly reasonable. However, comments throughout the report are more problematic, partly because they are in many cases not backed up by solid evidence, but also because they could lead to conclusions about the Department's contract management practices and exposures which cannot be sustained.

Thank you for the opportunity to comment on the proposed report.

Yours sincerely



PENNY ARMYTAGE
Secretary

RESPONSE provided by the Secretary, Department of Justice – continued**Attachment****PROPOSED AUDIT REPORT: MANAGEMENT OF PRISON ACCOMMODATION SERVICES USING PUBLIC PRIVATE PARTNERSHIPS**

Specific feedback from Department of Justice

Evolution of the State approach to public private partnerships (PPPs)

DOJ considers that insufficient allowance is given in the VAGO report to the fact that the contracts entered into for Fulham and Port Phillip prisons, signed in 1995 and 1996 respectively, occurred in the relatively early days of the State's use of this form of private financing initiative. These contracts, therefore, necessarily involved a less sophisticated understanding by all parties of the complexities and challenges of this type of funding arrangement. Judged by today's standards, some deficiencies are inevitably exposed, but the evolution in the State's approach to contract management that might have been predicted is barely taken into account in the report's findings.

As one example, section 3.2 concludes emphatically that "contract administration manuals ... are missing" with the clear implication (through the absence of any qualification) that this statement applies to all four prison accommodation services contracts. However, in section 3.6, we learn that the Department of Treasury and Finance only recommended such manuals in its 2003 *Partnerships Victoria Contract Management Guide*. There is a belated recognition later in that same section that the two earlier agreements "were signed before the guide was published", and that DOJ has since agreed to develop such manuals. There is also acknowledgement, on the following page, that such manuals do in fact exist for the other two facilities, although certain inadequacies are perceived. In several respects, therefore, the stand-alone conclusion of section 3.2 would appear both to misrepresent the prevailing circumstances and to be inconsistent with subsequent commentary.

Treatment of the accommodation services component of overall prison costs

It is regrettable that the relative overall value of the accommodation services in question, at Port Phillip and Fulham, is not adequately contextualised—i.e., as a proportion of the overall cost to the State of the full package of services required to operate these facilities. Some of the commentary on this subject, including the figures that are cited, is potentially misleading. For example, the report implies that the full accommodation service charge, inclusive of debt servicing component, is in theory available to the State in applying abatements. The report's deficiencies in these areas could result in inferences that are not sustainable about the overall value-for-money impacts on the State of the PPP arrangements as a whole. The findings that appear in the VAGO report relate exclusively to an analysis of the accommodation services component which, while not in itself insignificant, remains a relatively minor part of the overall economic equation.

Impacts of higher occupancy levels

DOJ considers that there is a lack of recognition in the VAGO report of the degree to which the facilities in question have coped with a higher than expected prisoner population over the period in question. The extent of use of temporary beds, including dual occupancy of prison cells, for instance, is likely to have impacted significantly on the life cycle of the asset and the maintenance outcomes that have been achievable. Equally, however, it is important to note that the value-for-money to the State over the contract term has for this reason been substantially greater than originally anticipated.

RESPONSE provided by the Secretary, Department of Justice – continued

Monitoring of contractors' performance on asset maintenance

I am pleased that the VAGO report acknowledges that DOJ has initiated a comprehensive Annual Accommodation Services Review (AASR) of the two private prisons. However, contrary to the comments made in the report, DOJ holds the view that regular physical inspections via the AASR process, together with the presentation of documented evidence of ongoing maintenance at individual sites, enable us to have a firm view of the level of services being provided during the performance year, and whether or not contractors are meeting their obligations to the State.

Condition of assets at end of contract term

On a number of occasions throughout the VAGO report, reference is made to the expectation that the State will receive the assets back, at the conclusion of the contract term, in a poorer condition than should occur. The DOJ position is that it has demonstrated on numerous occasions throughout the audit process that this will not be the case. There is a range of contractual protections to ensure that assets are returned in a fit-for-purpose condition, and incentives for the contractors to maintain the quality of the physical infrastructure. The report suggests that the State has little if any leverage over the contractors beyond the debt servicing period, a view not shared by DOJ as being supported by the available evidence. This scenario has at no time been envisaged by DOJ nor communicated to VAGO officers.

State leverage beyond current contract terms

New references to the 40- and 50-year Crown leases in the latest version of the report also fail to take into account the discretion available to the Minister in respect of alternative uses, which suggests a basic misunderstanding of the State's residual powers. Not only is there the option to extend the existing twenty-year facility terms for a further ten years (for Port Phillip Prison) and twenty years (for Fulham), but there is an explicit requirement under the leases for the Lessee to obtain Ministerial consent for any change to the permitted use after expiration of Facility Term. 'Permitted use' is defined as 'The development, construction, use and operation of a male prison in accordance with the Prison Services Agreement'.

At Port Phillip in particular, there are extremely strong impediments should the Lessee seek to achieve a change in permitted use. The Minister's consent is not subject to any test around reasonableness and the 'absolute discretion' test to granting consent (clause 17.13) therefore applies. At both sites, zoning issues also come into play: the land is currently a Special Use Prison zone and if any proposed change of use no longer accorded with this zoning, then the zoning would need to be amended accordingly which would be a further impediment to the Lessee.

DOJ has not articulated its plans for the period after the current terms expire and retains the option to raise all such eventualities in negotiations with the contractors well before the expiration of the facility terms. The opinions expressed in this part of the VAGO report are, therefore, again not supported by the available evidence.

DOJ responses to the individual recommendations follow.

RESPONSE provided by the Secretary, Department of Justice – continued

Recommendation 1

VAGO recommends that the Department of Justice should:

- Analyse the potential costs and benefits of modifying its existing contracts to enhance its ability to extract services at the highest standard possible.
- Independently audit key performance indicator data prepared by its contractors.
- Fully document its analysis of, and reasons for, decisions taken about time extensions to rectify faults and reductions in service payments.

DOJ comment: Supported in principle, but recognising that value-for-money considerations will be the principal determinant in negotiating and modifying contracts, which may not be consistent with achieving service delivery “at the highest standard possible”. Timing issues are also critical to such deliberations. Realistically, the cost of contract modifications will generally mean that, unless urgent, they should only be considered at times when key changes are otherwise envisaged.

Recommendation 2

VAGO recommends that the Department of Justice should:

- Complete the review of governance structures and use a single contract administration unit to manage significant contracted correctional services.
- Complete contract administration manuals for each contract including
 - developing risk management plans
 - incorporating best practice from the *Partnership Victoria Contract Management Guide* (2003) and the *Australian National PPP Policy and Guidelines* (2008) as applicable.
- Document its analysis and rationale for all contract variations and facility modifications.
- Maintain records of discussions at meetings with the Commissioner of Corrections to authorise contractor payments.

DOJ comment:

Supported / in train. The Department acknowledges that a single point of contract management is preferred to the structures that have applied to date, and proposes to make the necessary organisational adjustments.

Recommendation 3

VAGO recommends that the Department of Treasury and Finance should develop comprehensive guidance, for the Department of Justice and other departments, for the contract management of public private partnership projects during the operating phase.

DOJ comment: Not directly applicable but supported in principle.

Auditor-General's acquittal response to the Secretary, Department of Justice

VAGO

Victorian Auditor-General's Office

10 September 2010

File No: 25939

Ms Penny Armytage
Secretary
Department of Justice
121 Exhibition Street
Melbourne Vic 3000

Dear Ms Armytage,

Management of prison accommodation using public private partnerships

I refer to your letter of 8 September 2010 providing formal comments on the above audit.

Thank you for your acknowledgement both of VAGO's efforts to understand your department's concerns, and our extensive consultation underpinning the preparation of this report.

I am also pleased you see the audit as an important tool in your efforts to continually improve your management practices, and more importantly that you acknowledge that as a result of the audit, DOJ had begun initiating changes to its contract management practices and administration of prison public private partnerships (PPPs).

Notwithstanding these positive elements, I note your residual observations that the report fails to recognise "key contextual issues" applies inconsistent evidentiary standards and contains a disjunction between the tenor of its recommendations and the more critical commentary in its body.

I do not agree with these observations.

This office and your department have been through numerous and exhaustive iterations designed to elucidate and understand the context of this audit. Though you may disagree I am now satisfied that the contextual matters of this audit have been fairly represented.

Level 24, 35 Collins Street, Melbourne Vic. 3000
Telephone 61 3 8601 7000 Facsimile 61 3 8601 7010 Email comments@audit.vic.gov.au Website www.audit.vic.gov.au

Auditing in the Public Interest

Auditor-General's acquittal response to the Secretary, Department of Justice – continued

I also take issue with your view that over the course of this audit this office has applied rigorous standards of evidence to your department but in its own case, has relied upon assumption, opinion and unfounded conclusions. At the very least, I would have thought that the progress of this audit has been an object lesson in my office being prepared, repeatedly, to have its findings and conclusions tested, challenged and where justified, modified or changed. Indeed your own recent correspondence attests to this. Though you may believe otherwise, there is not and never has been one evidentiary standard for DOJ and another for VAGO.

Your other observation that there is a mismatch between the audit's "broadly reasonable" recommendations and its more critical, "problematic" comments in the body of the report strikes me as being a re-prosecution of areas of the audit findings which your Department continues to challenge but without an evidentiary basis for us to modify the audit findings. Though you may think otherwise I am satisfied that there is a clear alignment between the audit summary and the subsequent text which supports it.

It gives me no comfort that these areas of disagreement persist at the conclusion of this audit, particularly with your department which has demonstrated its commitment to an open and professional engagement with this office.

Against this background, I can only encourage you to continue the work you have embarked upon which this audit has prompted and I attach comments on specific issues you have raised in your letter.

Yours sincerely,



D D R Pearson
Auditor-General

Auditor-General's acquittal response to the Secretary, Department of Justice – continued

Attachment A

Evolution of the State approach to public private partnerships

VAGO maintains that the report sufficiently acknowledges the historical context and the changes that have occurred over time with these contracts.

The review commissioned by the department in 2000 pointed out deficiencies in the pre-2001 contracts and specifically recommended that DOJ consider amending the same. DOJ had not done so to date.

VAGO maintains that its conclusions in part 3 fairly represent deficiencies in DOJ's management of the prison PPPs. The fact that the *2003 Partnerships Victoria Contract Management Guide* was developed subsequent to the pre-2001 contracts does not prevent the department from now applying good administrative practices to the management of these contracts. I note that the DOJ has now commenced work to do just that.

Treatment of accommodation services component of overall prison costs

VAGO does not agree with DOJ's position that the accommodation service charge component of the costs in the contracts for Port Phillip Prison and Fulham Correctional Centre is not significant in determining the value-for-money. As stated in the report, value-for-money is driven by whole-of-life costing which includes design, construction, service delivery, operating, maintenance and refurbishment costs.

Impacts of higher occupancy levels

While DOJ first raised this after the proposed draft was issued, this further highlights the need for appropriate maintenance strategies to be in place. The additional use of the facilities 'is likely to have impacted significantly on the life cycle of the assets' and therefore the argument for adequate maintenance strategies and adherence to quality standards is all the more cogent.

Whether or not this situation improves the value-for-money obtained by the state is a question of fact and will depend on whether the additional costs to the state are ultimately reflected in better whole-of-life cost outcomes for these prisons.

Monitoring of contractors' performance on asset maintenance

The AASR provides for the preparation and implementation of a maintenance plan for faults identified during the three day annual review. While VAGO acknowledges that the implementation of the AASR is a step in the right direction, it does not address the need for regularly scheduled and preventative maintenance of the facilities throughout the year.

Conditions of assets at end of contract / State leverage beyond current contract terms

The contracts for the pre-2001 PPPs are silent on the standard of facilities when they are returned to the state. In addition, the full payment of the debt service component by 2012 for Port Phillip Prison and 2017 for Fulham Correctional provides a reduced incentive for the contractor to maintain the quality of the buildings beyond these dates.

In addition the complexity created by the Crown leases further undermines the state's leverage to assure appropriate maintenance of the facilities. VAGO's point is that DOJ had not demonstrated that it is managing this risk.

Auditor-General's reports

Reports tabled during 2010–11

Report title	Date tabled
Portfolio Departments: Interim Results of the 2009–10 Audits (2010–11:1)	July 2010
Taking Action on Problem Gambling (2010–11:2)	July 2010
Local Government: Interim Results of the 2009–10 Audits (2010–11:3)	August 2010
Water Entities: Interim Results of the 2009–10 Audits (2010–11:4)	August 2010
Public Hospitals: Interim Results of the 2009–10 Audits (2010–11:5)	September 2010
Business Continuity Management in Local Government (2010–11:6)	September 2010
Sustainable Farm Families Program (2010–11:7)	September 2010
Delivery of NURSE-ON-CALL (2010–11:8)	September 2010

VAGO's website at <www.audit.vic.gov.au> contains a comprehensive list of all reports issued by VAGO. The full text of the reports issued is available at the website.



Victorian Auditor-General's Office

Auditing in the Public Interest

Availability of reports

Copies of all reports issued by the Victorian Auditor-General's Office are available from:

- Information Victoria Bookshop
505 Little Collins Street
Melbourne Vic. 3000
AUSTRALIA

Phone: 1300 366 356 (local call cost)
Fax: +61 3 9603 9920
Email: <bookshop@diird.vic.gov.au>
- Victorian Auditor-General's Office
Level 24, 35 Collins Street
Melbourne Vic. 3000
AUSTRALIA

Phone: +61 3 8601 7000
Fax: +61 3 8601 7010
Email: <comments@audit.vic.gov.au>
Website: <www.audit.vic.gov.au>