Melbourne Markets Redevelopment

Victorian Auditor-General's Report

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

The Hon. Bruce Atkinson MLC
President
Legislative Council
Parliament House
Melbourne

The Hon. Ken Smith MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report on the audit *Melbourne Markets Redevelopment*.

Yours faithfully

D D R PEARSON
Auditor-General

14 March 2012

Contents

Audit summary

The Melbourne Wholesale Fruit and Vegetable Market incorporating the National Flower Centre is an important part of the state's economic infrastructure, with an annual turnover in excess of $1.6 billion.

The market is being relocated from its current site in Footscray Road to a new site in Epping. The intention is to establish the new market within a modern, innovative and efficient fresh produce trading and distribution precinct. This is one of the largest infrastructure projects undertaken in Victoria in recent years.

The new market has three main components required for its effective operation:

- a trading floor, where produce is displayed, bought and sold
- warehousing and cool storage used to store and distribute produce
- fit-out of leasehold areas to facilitate the business needs of each lessee.

In purchasing the site for the market, the government acquired additional land to develop a market precinct.

Conclusions

The initial project planning and governance arrangements for the relocation were sound. However poor project implementation has adversely affected the project.

Poor stakeholder management has:

- significantly delayed the relocation of the market—it was originally planned to move in 2008, however, an operational market is still at least two years away
- resulted in significant cost increases—the expected cost to government is more than double the $230 million included in the 2004 business case
- had an adverse impact on tenant investment in this industry.

Issues relevant to the tenants' decision to relocate to Epping have not been resolved and they are still not committed to the move. As a result, the relocation is not assured.

Management of market tenants contributed to a number of adverse events during the first five years of the project. The subsequent decision to abandon the proposed Partnerships Victoria procurement approach and enter into a memorandum of understanding (MOU) with the market community to deliver significant parts of the project was made without proper assessment of the options and associated risks.

Failure to update governance arrangements and project management plans and to produce detailed project financials following these changes contributed to poor outcomes.

Significant shortcomings in the procurement of the trading floor mean that the process was not demonstrably fair and the evaluation process did not assure that the price to be paid to the successful tenderer represented the best value-for-money.

Findings

Achievement of project objectives

The project was set a number of redevelopment and operational objectives. Given delays in the project, only three of the redevelopment objectives can be assessed at this time. There has been a failure to meet each of these project objectives:

- **Redevelop the market into an innovative modern facility by 2008**—changes to scope and project delivery methods have delayed the move to a more efficient market. A fully operational market is at least two years away, and if delivered as proposed will be six years later than originally planned.
- **Ensure buy-in by market participants**—the responsible agencies have not adequately addressed the needs of the market community or managed their expectations. Tenants have not been provided with the financial and other information they need to make a fully informed decision on whether to move.
- **Ensure the state's investment in the new market provides value for money, is sustainable and delivered within budget**—at the end of 2011 the projected cost of the market relocation was around double the $300 million budget set in the business case, and now includes warehousing that was not in the original scope of the project. Further, the tender process for the trading floor failed to demonstrably deliver value-for-money.

Decision to abandon the Partnerships Victoria arrangement

The Department of Primary Industries' (DPI) decision to significantly change the project delivery model in 2007, to one that relied on a $2 company established by some members of the market community to deliver significant parts of a billion dollar project, created significant risks. Particularly as:

- there was some doubt whether the company fairly represented the views and interests of the whole market community
- the market community did not have the skills or resources required to manage the delivery of its part of the project or to find, negotiate and enter into appropriate contractual arrangements with suitable private sector companies to construct warehousing and develop the market precinct.

Change management

The business case, initial governance arrangements and project planning were sound. However, a number of significant changes made during the project adversely affected the achievement of its objectives. These changes included:

- three different project delivery methods involving different parties delivering parts of the project and owning and operating the market
- a significant change in the design of the trading floor after the successful tenderer had been announced.

Transferring administrative responsibility from DPI to the Department of Business and Innovation (DBI) in 2009 caused some delays in progressing key elements of the project, although the change has seen an improvement in the overall management of the project.

The changes to the project scope and delivery created risks that were not well managed. Specifically:

- the business case, governance arrangements and the project implementation plan were not updated on a timely basis to reflect changes to scope, delivery strategies and the roles of government agencies and private sector organisations
- the state government assumed responsibility for the provision of warehousing in April 2009, however, DBI is still developing a business case and plan for the warehousing
- detailed project financials were essential to the management of the project, however, at the end of 2011 the scope of the works and financial information was still not sufficiently developed to enable DBI to commence negotiations with tenants on market leases and assess the financial viability of the project.

Risk workshops were held, a register identifying project risks was maintained and high-level risk plans were developed. However, a detailed risk management plan was not prepared and for most of the project DBI, DPI and Major Projects Victoria (MPV) did not actively monitor and manage project risks. DBI addressed this issue in 2011.

Stakeholder management

Stakeholder management has not been effective. Although the business case identified relevant stakeholders, recognised the importance of stakeholder management, and DPI initially set in place good stakeholder management processes, poor outcomes occurred. These included:

- an alliance of market participants opposing the relocation of the market
- a group of tenants starting legal action against the Melbourne Markets Authority (MMA) and placing caveats on land at Footscray to stop the government from using the market land for another purpose or selling it
- some tenants threatening to establish rival markets.

Market tenants operate in an environment of intense competition, where transactions occur quickly and are heavily dependent on price. What is important to them in the relocation is their ability to continue their business at the new site and make a profit.

DPI planned to provide tenants with the information they needed to make an informed decision on the move and to start negotiations with tenants in late 2006. However, this did not happen.

Uncertainty around tenure, and not being provided with relevant cost and other information, has led to tenant resistance to the market relocation. At the end of 2011, this information had still not been provided to them.

Tenants have not been told how their warehousing needs will be met at the new market and the likely cost of the warehousing. This has also delayed the move to Epping and this delay has added to the cost of the relocation. Although construction of the trading floor is expected to be completed in 2013, the new market cannot operate until construction of the warehousing is completed in 2014–15.

Trading floor procurement

A number of probity matters in relation to the trading floor procurement cast doubt on the fairness of the procurement process. MPV's practices showed:

- an inadequate understanding of the importance of demonstrating probity in public sector procurement
- a poor understanding of the identification and management of conflicts of interest
- a lack of commitment to transparency.

While these factors may not have changed the outcome of the tender, the conduct of the procurement means that MPV cannot provide sufficient assurance that the process was fair. Furthermore, the tender only attracted one fully costed, adequately supported, reasonably priced tender that met MPV's contractual requirements. Along with poorly considered decisions made during the procurement process, this is likely to result in the government paying more for the trading floor than they should.

Recommendations

Number	Recommendation	Page
1.	The Department of Business and Innovation and the Department of Primary Industries should implement appropriate project management policies and procedures so that: • the options and risks associated with proposed changes to project scope, size, delivery methods and administrative arrangements are critically assessed and documented prior to actioning them • once changed, governance arrangements, business cases and project implementation and management plans are appropriately updated in a timely manner.	20
2.	The Department of Treasury and Finance should provide more definitive guidance on better practice project management in its Investment Lifecycle Guidelines.	20

Recommendations – *continued*

Number	Recommendation	Page
3.	The Department of Business and Innovation should: • immediately provide further information to tenants, including finalisation of allocation of new space at the new market, to provide certainty and allow investment decisions to be made • implement a clear and robust engagement strategy for the remainder of the project.	29
4.	Major Projects Victoria should: • revise its procurement policy and operating procedures to align with contemporary better practice in public sector purchasing • provide regular probity training for all staff involved in procurement activities.	44
5.	The Department of Treasury and Finance should: • require agencies to obtain related interest declarations from project staff for each procurement project on which they work • develop processes to assess the quality of service of probity practitioners.	44

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 was provided to the Department of Business and Innovation, the Department of Primary Industries, the Melbourne Market Authority, the Department of Premier and Cabinet and the Department of Treasury and Finance 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 however, are included in Appendix A.

1 Background

1.1 Relocation of the market

Melbourne's Wholesale Fruit and Vegetable Market and the National Flower Centre are an important part of the state's economic infrastructure, with an annual turnover in excess of $1.6 billion. Both are owned by the state and operated by the Melbourne Market Authority (MMA).

The government announced in 2004 that the market would be relocated to a new site. The intent was to locate the new market within a modern, innovative and efficient trading and distribution precinct.

The new site will comprise:

- **a trading floor**—where buyers and sellers exchange produce
- **warehousing to meet current and future market needs**—for cool and other storage needed for the market to operate efficiently and effectively
- **a commercial precinct**—to support market-related activities.

1.2 Project delivery

Initially the project was to be delivered as a public private partnership under the government's Partnerships Victoria (PV) framework, with completion planned for 2008.

However, the delivery method and the arrangements for the operation and ownership of the market have changed twice since the project commenced.

1.2.1 Partnerships Victoria arrangement 2004–07

The delivery model outlined in the 2004 business case was for the project to be delivered under a PV arrangement. This involved the state entering into a 25-year contract with a private sector company to design, build, finance and maintain the trading floor.

Under the arrangement, the state would purchase the land and lease it to a private company to construct the market trading floor. The state would pay the company a fee to use and maintain the trading floor, which it would lease to market tenants. After 25 years, ownership of the trading floor would revert to the state.

The business case indicated that the private sector or market users would be responsible for the warehousing, but did not outline how this would be facilitated. Fit-out would be the responsibility of lessees.

1.2.2 Memorandum of understanding 2008–09

During 2007 a group of market tenants approached the government with a proposal to support the relocation of the market to Epping in exchange for the market industry having an opportunity to purchase the market.

Following extensive negotiations with tenants, the government entered into a memorandum of understanding (MOU) with Victoria Fresh Markets Pty Ltd (VFM). VFM is a private company owned by Fresh State, a group representing market wholesalers. The MOU outlined the principles under which the market was to be developed and provided for the creation of four companies. The companies were:

- a government company to initially own and control the market assets
- a private company to operate the market
- a private company to build warehousing and develop other land on the site, subject to approval by government
- a private company used to transfer ownership of the market to the industry.

Following the creation of the MOU, the government decided not to continue with the PV arrangement and to engage a private sector company to design and construct the trading floor.

In February 2008 a joint venture agreement was created between VFM and a private sector company to build the onsite warehousing adjacent to the market trading floor and to develop part of the other land on the site to create a market precinct. This agreement subsequently lapsed in late 2008, due to a dispute over the respective obligations of the joint venture parties.

In October 2009, the MOU arrangement was discontinued, with the state taking responsibility for the provision of the warehousing.

1.2.3 Current arrangements since 2009

Since the discontinuation of the MOU, there has been no decision on the long-term ownership arrangements of the market. In May 2010, the Minister for Major Projects appointed MMA as the market operator during the relocation and early years of operation.

Figure 1A provides a time line of the key events associated with the project.

Figure 1A
Key events associated with the project

Date	Key events
June 2002	Government endorses the preparation of a feasibility study and business case for the redevelopment of the market.
April 2004	Government releases *Victoria: Leading the Way Economic Statement* in which the project is formally announced.
February 2005	Government approves funding of $230 million. The remaining funding is to be provided through a $70 million Treasury Corporation of Victoria loan.
	PV arrangement
August 2005	Government decides to deliver the project under a PV arrangement and assigns administrative authority to the Department of Primary Industries.
May 2006	Market community discontinues its involvement in the project.
November 2006	Four tenants commence a class action against MMA.
April 2007	A proposal for the market to be owned and operated by the market community is put to government.
	Memorandum of understanding
December 2007	Government enters into an MOU with VFM for the construction of the warehousing and other market related development. PV process is abandoned. Major Projects Victoria is to deliver the trading floor.
May 2008	Government approves VFM's joint venture partner.
November 2008	Joint venture agreement breaks down. Government approves commencement of the trading floor procurement process.
April 2009	Ministerial responsibility transferred from the Minister for Agriculture to the Minister for Major Projects and the Department of Business and Innovation assumes administrative responsibility for the project. Government approves over $190 million of additional funding subject to a revised business case.
May 2009	Major Projects Victoria releases a request for tender for the design and construction of the trading floor.
September 2009	Preferred contractor appointed.
October 2009	MOU process is discontinued.
	Current arrangement
December 2009	The Department of Business and Innovation submits a revised business case to the Department of Treasury and Finance.
March 2010	Contract for the construction of the trading floor is signed.
May 2010	MMA appointed as market operator.
December 2010	Government undertakes a strategic review of the project.
June 2011	Government decides to continue with the project and approves additional funding.

Source: Victorian Auditor-General's Office.

1.3 Administrative arrangements

At its inception, both the Minister for Agriculture and Minister for Major Projects were responsible for the project, with the Department of Primary Industries having administrative responsibility. On 6 April 2009, the Minister for Major Projects assumed sole responsibility for the project and administrative responsibility was transferred to the now Department of Business and Innovation.

Major Projects Victoria has been responsible for the delivery of the trading floor since December 2007.

The departments of Premier and Cabinet and Treasury and Finance have had an oversight and advisory role in the project through their membership on the project's interdepartmental steering committee.

1.4 Audit scope, method and cost

1.4.1 Audit objective and scope

The audit evaluated whether the redevelopment was effectively planned, procured and managed.

The audit examined:

- initiation, planning and management of the market redevelopment
- procurement planning and management
- project delivery to the end of 2011.

The audit examined the roles played by the Department of Primary Industries, the Department of Business and Innovation, Major Projects Victoria and the Melbourne Markets Authority, as well as the oversight provided by the Department of Premier and Cabinet and the Department of Treasury and Finance.

1.4.2 Audit method and cost

The audit was performed in accordance with the Australian Auditing and Assurance Standards. The total cost was $615 000.

1.4.3 Report structure

The structure of the report is:

- Part 2 – project initiation, planning and management
- Part 3 – stakeholder management
- Part 4 – trading floor procurement.

2 Project initiation, planning and management

At a glance

Background

Project success depends on effective project planning and management.

Conclusion

While initially well planned, critical changes to the project have not been effectively managed, affecting both the timing and cost of the project. The project will be six years late and more than double the original cost.

Findings

- There was a clear business case to relocate the market.
- While the project was initially well planned, governance arrangements, planning and project management documents and financials were not updated in a timely manner to reflect significant changes in scope, administrative arrangements and project delivery methods.
- A major change in the delivery of the project was made without proper consideration of options and associated risks.
- The cost of the project to government will be more than twice the $230 million budget provided in the 2004 business case.

Recommendations

The Department of Business and Innovation and the Department of Primary Industries should implement appropriate project management policies and procedures so that:

- the options and risks associated with proposed changes to project scope, size, delivery methods and administrative arrangements are critically assessed and documented prior to actioning them
- once changed, governance arrangements, business cases and project implementation and management plans are appropriately updated in a timely manner.

The Department of Treasury and Finance should provide more definitive guidance on better practice project management in its Investment Lifecycle Guidelines.

2.1 Introduction

The market redevelopment project was large, complex and risky, with inevitable trade-offs between project objectives. Significant changes occurred throughout the project requiring:

- careful consideration of options going forward and the associated risks
- timely adjustments to governance arrangements, project plans and financials.

2.2 Conclusion

The proposal to relocate the market was adequately assessed and supported and the application of the Partnerships Victoria (PV) framework to the project was reasonable.

The Department of Primary Industries (DPI) established appropriate governance arrangements and organisational structures to manage and oversee the relocation, and prepared a plan to deliver the project.

Actions taken during implementation, including changes to delivery methods, administrative arrangements and the project's scope, adversely affected the achievement of the project's objectives and other project management elements. The project will be around six years late and more than double its original cost.

There was insufficient consideration of the options and associated risks before some actions were taken and decisions made—notably, the decision to replace the PV delivery arrangement in favour of the memorandum of understanding (MOU) with the market community.

2.3 Project initiation

2.3.1 The case to relocate the market

The Melbourne Market Authority (MMA) had to demonstrate the need for the relocation and determine the structure and size of the new market. This was done through the preparation of a feasibility study commissioned by Major Projects Victoria (MPV) in 2002.

The feasibility study reviewed the current and future operations of the market and concluded that there was a need for a centralised wholesale market, the existing site was too small to sustain future growth beyond 2008, and the best long-term use for the current site was for port and rail activities.

The relocation was also planned to address other problems with the Footscray site including:

- occupational health and safety issues identified by WorkSafe
- the lack of a temperature controlled environment
- issues with vehicle emissions
- inefficiencies resulting from the layout of the market.

The feasibility study estimated it would cost $239 million to redevelop the market on the current site and $313 million to relocate it. The benefits from relocation were estimated to be worth $860 million:

- a $401 million increase in Victoria's gross state income would be generated by building a new market
- $459 million would be raised by using the current site for port and transport related activities.

Even without using the Footscray site for another purpose, the estimated benefits derived from relocating the market exceeded the projected cost. However, as indicated in the feasibility study, the main reason for the move was to make the Footscray Road site available for other uses.

2.3.2 Establishing project objectives

Five redevelopment and four operational policy objectives were outlined in the business case. However, some objectives were incompatible with others. For example, the objective of ensuring the buy-in of existing market participants was inconsistent with the objective of creating a competitive environment at the new market that encouraged new market entrants. If tenants were to be forced to move they wanted to retain their existing competitive positions in the new market. This impacted on the competitive environment and ability to introduce new tenants in the new market.

Furthermore as the project has progressed, conflicts between some objectives created significant problems. The government's 2007 decision to enter into an MOU arrangement with a company representing the market community helped obtain tenant support, but impacted on objectives to:

- maintain government control over key aspects of the trading facility
- achieve value-for-money from the government investment.

There was also a significant risk that the objective to relocate the market within project time lines and budget would not be achieved.

The business case did not recognise the inevitable trade-offs between project objectives. It did not attempt to prioritise or weight objectives, or develop strategies to address situations where the achievement of one objective adversely impacted on the achievement of another. A DPI review of the business case recognised the risks to the project of using a set of objectives that were in conflict. While these concerns were raised with the interdepartmental steering committee in October 2004, no changes were made to the objectives, and no strategy was developed to address these conflicts.

2.3.3 Determining the market structure and size

The broad market structure and size were determined and included in the business case.

MMA engaged a consultant to undertake a demand analysis for the current and future market. Based on this analysis, DPI and MPV decided that the new market would require a trading floor area, similar in size to the existing trading floor and require 12 hectares of warehousing (three times the warehousing at Footscray Road). By 2028, the demand for trading floor and warehousing space were both projected to increase.

While the consultant's report projected a growing market, a 2004 Gateway review of the project business case predicted that demand for future trading floor space would diminish over time. A June 2006 report by another consultant advised that market throughput was likely to decrease by 25 per cent due to a rise in direct sourcing of produce from farms.

While these reviews were completed well before the release of the trading floor request for tender in May 2009, no assessment was made of the impact of the more recent demand projections on the proposed structure and size of the market.

2.3.4 Supporting the proposal with a business case

Sound investment planning involves a strategic assessment, options analysis and adequate support for the preferred solution.

Assessing the project delivery options

The 2004 business case assessed the following delivery models for the trading floor facility:

- traditional state build for the entire facility
- traditional state build for the trading floor and private construction and ownership of warehousing
- design, build, finance, maintain under a PV arrangement
- design, build, finance, operate under a PV arrangement
- privatise the market
- strata title.

The design, build, finance, maintain model was selected as the preferred option.

Was the business case sound?

The business case drew together the work in the strategic and options analyses and clearly demonstrated why the preferred solution should be supported. The significant elements of a good business case were included.

Specifically the business case:

- adequately supported and demonstrated the benefits of the proposal
- assessed and evaluated the options
- quantified the net value and outlined the risks inherent in the relocation
- assigned a project sponsor who had the capability and authority required to complete the project
- outlines how the outcomes were to be delivered and benefits to be measured.

The only significant areas where the business case was deficient were in relation to project costing and time frames.

The project was not fully costed prior to seeking funding. Site preparation, project management and other costs not provided for in the business case represent tens of millions of dollars.

The proposed date of the market relocation in the business case was 2008. In May 2005 this was changed to 2010.

2.3.5 Approval and funding

In February 2005, the government considered the business case and approved a project budget of $300 million for the purchase of a suitable site and construction of the trading floor and associated infrastructure. No funding was provided for warehousing or other site development.

At the time, the estimated annual net operating surplus of the new market could only support about $70 million in debt. DPI proposed having the remaining cost of the project funded by the government. This was effectively a government subsidy to the market community. The debt funding was to come from Treasury Corporation of Victoria.

Tenant rental and service charges were to be used to repay the loan.

2.4 Project planning

DPI's overall project delivery strategy was reasonable and supportable.

A project implementation plan was developed for the PV arrangement.

The project plan and project schedule attached to the copy of the plan submitted to the Project Control Board for approval on 27 September 2006 included the information normally expected, except it did not:

- outline actions required to achieve the key milestones, or assign responsibility for their delivery
- establish the external resources required over the project life, or include a plan to acquire or use external consultants or advisors.

Project schedules subsequently produced by DPI included the detailed actions required to deliver the milestones, but still did not assign responsibilities.

2.4.1 Project governance

The governance arrangements initially established for the project were reasonable for the size and complexity of the project.

The Minister for Agriculture and Minister for Major Projects were both jointly responsible for the project and DPI had administrative responsibility. The department established a governance and administrative structure for the project that included:

- **a project control board**—responsible for the overall decision-making with senior representation within DPI, including two deputy secretaries
- **interdepartmental steering committee**—responsible for strategic guidance and direction and seeking ministerial approval for major strategies. DPI, the Department of Premier and Cabinet (DPC), the Department of Treasury and Finance (DTF), MMA and MPV were represented on the committee
- **project sponsor**—Deputy Secretary of DPI
- **project team**—project director and eight staff.

The project team had access to specialist commercial, financial, legal, design, property and other technical advisors.

However, under the governance arrangements of the MOU, DPI reported to the Minister for Agriculture, while MPV reported to the Minister for Major Projects. This created tension between DPI and MPV. DPI wanted MPV to work under its instruction, while MPV wanted to remain independent of DPI and remain reporting to the Minister for Major Projects.

An agreement outlining the governance, working arrangements and the roles of MPV and DPI in the procurement process were agreed to by both parties in December 2005.

2.5 Managing change

In the eight years since the relocation was proposed, the project scope, delivery method, ministerial responsibility, administrative arrangements, and ownership and operation of the market have changed.

2.5.1 Adapting project arrangements

Given the significance of the changes to project scope, delivery and administrative arrangements, there was a need to substantially revise or replace the major project plans, governance arrangements and processes to reflect these changes.

The audit found several issues:

- The business case was not revised by DPI as a result of the move to the MOU arrangement and although a revised business case was produced in 2009 to support the Department of Business and Innovation's (DBI) application for additional funds, it was not sufficiently robust and detailed.
- While the project implementation plan was updated by DPI to reflect the MOU arrangement, a revised plan for the current arrangements was still being developed by DBI at the end of 2011.
- Problems identified with project governance were not addressed and the governance processes for the current delivery arrangements were still being reviewed in late 2011.
- Detailed project financials, required before negotiations with tenants on rentals in the new market can commence and needed to establish the viability of the project, were still not finalised at the end of 2011.
- Project management documentation such as budgets, high level risk management plans and stakeholder management plans were revised to reflect the changing delivery methods and administrative arrangements. However, pre-lease agreements, detailed risk management plans, plans for warehousing and the use of development land were either not completed or not completed in a timely manner.

DBI completed a project investment logic map in late 2011 and by November 2011 was developing or waiting for the following documents to be approved by the department:

- market operating rules
- tenant fit-out guide
- transition plan
- business plan for the Epping market
- leasing strategy and documentation
- probity plan
- financial model
- warehousing business case
- financial management plan.

Changing governance and administrative arrangements

Effective project management in light of these changes also required responsive governance and administrative arrangements.

Interdepartmental steering committee

Under the PV arrangement the interdepartmental steering committee reported directly to the secretary of DPI and acted as a decision-making body. However, once negotiations on the MOU commenced, the committee's role became less clear, with DTF and DPC representatives on the committee indicating to VAGO they were less able to directly influence the management of the project.

When the current project delivery arrangements were established, the committee continued in its advisory role and its terms of reference were updated in 2011. However, at the end of 2011, the terms of reference were still not satisfactory to DPC or DTF.

Project control group and steering committee

On the transfer of responsibility to DBI the department created a project control group. This group was the key decision-making body.

In August 2011 DBI prepared a document outlining a new governance structure for the project and prepared draft terms of reference for the project control group and the project steering committee. Key changes to the structure included:

- MPV reporting to the project control group, the Deputy Secretary, Investment and Major Projects and the Minister for Major Projects, instead of only to the Minister for Major Projects
- the DBI project director reporting to the project control group, instead of to the project sponsor.

At the end of 2011, the arrangements to underpin the new structure were still being developed, including the roles of DPC and DTF.

Roles of the departments of Primary Industries and Business and Innovation, and Major Projects Victoria

After the PV arrangement was discontinued, the construction of the trading floor and the other elements of the project effectively operated independently of one another. This arrangement failed to recognise the inter-dependency of the work performed by both agencies and the need for them to coordinate their activities.

While DPI had administrative responsibility for the project, both MPV and DPI were focused on the delivery of their respective components of the project without due consideration of the other's role.

When the project transferred to DBI in April 2009, this situation continued until September 2009, when the roles and responsibilities were reviewed and agreed on. However, a DBI review of the project's governance arrangements, completed in December 2011, found that there was still no direct reporting from MPV to the DBI project director.

Project management team

The original project management team was appropriate for the project. When DBI became responsible for the project, DPI's project director, commercial director, project program coordinator and major advisors moved to DBI. The former project director's involvement in the project after he moved to DBI was limited and he returned to DPI in July 2009. As a result his extensive knowledge was lost to the project.

Since then the project has lacked a dedicated project director with oversight responsibility for the entire project. For a large portion of the time that the project was administered by DBI, the role of project director was jointly shared by up to three individuals.

Where project management is shared, no individual takes overall responsibility for the project. There is a risk of duplication of effort, it is easy for staff to get mixed messages and decisions can be made in one area without due consideration of their impact on the wider project.

Recent governance changes

On 23 August 2011, DTF wrote to DBI outlining a number of requirements that needed to be met in order for DBI to access the additional funding sought. These requirements included:

- obtaining the approval of the Treasurer for each major step in the warehousing procurement process including registration of interest / expression of interest release, request for tender, confirmation of preferred bidder and contract execution
- having pre-lease commitments with tenants in place before the warehousing construction commences.

DTF also required DBI to provide it with a project implementation plan and an optimised Treasury Corporation of Victoria (TCV) debt profile. This requires DBI, in establishing rents for market tenants, to optimise its use of TCV debt at a sustainable level to minimise the cost of the project to the government.

The consultant's December 2011 report on the project's governance arrangements recommended that the project steering committee become a strategic decision-making body and the project director be the single point of accountability and control for the project.

2.5.2 Changes to the delivery strategy

In this project, some actions were taken and decisions made without evidence of adequate consideration of the options and associated risks. Foremost was the decision to discontinue the public private partnership delivery arrangement and enter into an MOU with the market community.

This decision was taken in response to market community resistance to the relocation in late 2006. There is little evidence that DPI applied the same level of rigour to the decision to deviate from the approved delivery arrangement as it had applied to the development of the original business case.

While staying with the PV arrangements was one of five options considered by DPI, the significant risks associated with the MOU process were not identified and fully assessed.

The decision to change the delivery strategy

During 2006, the strategic alliance, an organisation representing groups within the market community, became increasingly dissatisfied with the way the redevelopment was being managed. Their main concern was the government's inability to put an offer to them with sufficient information to enable them to assess the financial impact of the relocation on their business. Because DPI did not provide this, the strategic alliance decided to cease their involvement in the project.

In November 2006, a group of tenants commenced a class action against MMA.

In early 2007, a group purporting to represent the industry approached the government with a proposal to work together on the relocation in exchange for the industry having an opportunity to own the market.

DPI considered that private companies would not enter into the proposed PV arrangement without market community support and decided that a new arrangement involving the potential privatisation of the market was the only way to progress the project.

The memorandum of understanding arrangement

Following negotiations between DPI and the strategic alliance, the department recommended to the government that the PV arrangement be discontinued and a new arrangement be developed. Both DPC and DTF supported the new arrangement.

The government agreed to:

- DPI constructing the trading floor using a design and construct contract
- enter into an MOU with Victoria Fresh Markets Pty Ltd (VFM), a private company with one share owned by Fresh State, a body representing market wholesalers, to build and operate warehousing and be involved in the development of a market precinct.

The decision to enter into an MOU was made without proper consideration of options and associated risks. Notably, the market community and VFM were not capable of delivering their part of the project. A proper assessment would have highlighted this. This assessment was not done until some ten months later when VFM had failed to meet its obligations under the MOU. Furthermore, VFM did not demonstrate it had the strong support of the majority of members of each major market group.

The MOU was a non-binding agreement between the state and VFM that outlined the legal and commercial framework for the establishment of detailed contracts to be entered into by the parties. VFM had until the end of August 2008 to establish these contracts.

On 26 February 2008 a joint venture arrangement was signed by VFM and a private sector company. The suitability of VFM's joint venture partner was subsequently endorsed by the government on 12 May 2008.

In setting up the MOU, the government was transferring the management of significant parts of the project to a non-government organisation—VFM—and the market community. Before doing so, DPI needed to be assured that VFM:

- would fairly represent the views of the market community
- had the skills and resources to manage their part of the project
- was capable of operating the market
- had enough time to meet the MOU requirements.

Representing the interests of the market community

The strategic alliance supported the establishment of VFM. However, Fresh State held the only share in the company, had two of its members on the five member VFM board, was the guarantor for VFM, provided 70 per cent of the company's initial funding and had significant involvement in the preparation of the MOU.

The risk for the government was that Fresh State would use VFM to further the interests of its members at the expense of other market participants. To address this, the MOU required:

- strategic alliance members (peak industry bodies) to authorise VFM to enter into the MOU on their behalf (which they did in December 2007)
- VFM to have an independent chair (who was appointed in 2008).

Prior to signing the MOU, DPI also asked VFM to demonstrate that it represented and had the authority to act on behalf of all members of each peak body in the market community.

On 21 April 2008, VFM advised DPI that it had obtained deeds of authority from market participants. At the end of this process VFM was only able to demonstrate strong support from two of the six market groups. Only 61 per cent of the Vegetable Growers Association and 18 per cent of the Fruit Growers Victoria signed deeds. No members of the Victorian Retail Fruiterers Associations or unloading agents signed deeds.

While not all the authorities required were received, the number signed was accepted as sufficient by the project steering committee.

Capability of Victoria Fresh Markets

With the change in strategy, there was a risk that appropriate contractual arrangements would not be established within the specified time frame, having an adverse effect on project costs and time lines, and the government's reputation.

To perform its role under the MOU, VFM needed experience and capability in project management, procurement, managing leasing arrangements, maintaining warehousing, negotiating construction contracts with private sector companies, and organising project financing. VFM also needed the financial resources to:

- engage project management staff and advisors
- establish governance arrangements.

VFM was a newly created company with no financial resources or staff. As the market community was not in a position to provide these resources and staff, VFM had to seek a private sector partner.

In its dealings with private sector companies and financiers, VFM could be influenced by organisations offering it financial support. This influence might lead to VFM entering into contractual arrangements that were to the detriment of the project and the broader market community.

In these circumstances it would have been prudent for DPI to undertake a due diligence assessment of VFM and the market community to determine whether they were capable of meeting the MOU obligations. This was not done until the end of 2008, when the MOU was initially due to expire and its requirements remained unmet.

The MOU required the following documents and processes to be prepared and approved by the government, within the life of the MOU:

- establishment plan and governance framework for VFM
- joint venture agreement/s with private sector company/ies
- a head lease and operating deeds
- options and a contract of sale for the sale of development land
- documents in relation to any external funding
- security documents and guarantees.

If VFM failed to meet these requirements, its role in the project ceased.

This arrangement was designed to give assurance that the warehousing and site development managed by VFM would be delivered in a manner consistent with government objectives and provide a safeguard if VFM could not negotiate suitable arrangements with the private sector.

The success of this approach was dependent on:

- VFM having the capability to negotiate arrangements with private sector companies to deliver the best outcomes for the market community
- the government, through its approval process, being able to influence the contracts between VFM and other external parties.

But when tested, the government had little influence over the joint venture agreement. While it was signed and VFM's partner approved by the government in May 2008, it was not until September 2008 that DPI asked to see the agreement. Following its review of the agreement, the department had a number of concerns including conflicts of interest, the suitability of the joint venture relationship and the influence of a joint venture partner on VFM's decision-making. These concerns were never resolved.

Capability of Victoria Fresh Markets to operate the market

As neither VFM nor its joint venture partner had experience operating a large market, there was a risk that they may not be capable of doing so. No assessment was ever undertaken on VFM's capability to be the market operator.

As operator of the Footscray Road market, MMA had the expertise to assist VFM in operating the new market. While VFM had access to MMA's records, and VFM appointed a former chief executive officer of the market to assist it, DPI decided that the company should establish the operating arrangements for the new market without MMA's direct involvement.

Time to meet the memorandum of understanding requirements

Another risk was that VFM and its partner may:

- not have had enough time to meet its obligations under the MOU
- have rushed the preparation of the joint venture agreement, and with more time to evaluate the implications of the arrangement one or both parties may have wished to change the agreement and/or the MOU.

In a briefing to government in May 2008, DTF indicated that the biggest risk to the MOU was VFM's ability to harness the necessary resources to undertake its obligations within the time frame set.

VFM was given just over six months to meet its obligations under the MOU. With the exception of the joint venture agreement none of the requirements were met, even after the government extended the time frame by another month.

Discontinuation with the memorandum of understanding process

By the end of August 2008, VFM had made progress on developing many of the documents required by the MOU, but with the exception of the joint venture agreement had not finalised any of them. The government granted VFM an extension to 30 September 2008 to meet its obligations, but again, these were not met.

The government issued the company with a show cause letter asking it to demonstrate why the MOU should not be dissolved. VFM's response was found to be inadequate, however, the government continued to negotiate with VFM to deliver the project and gave the company until the end of June 2009 to reach an agreement on a revised MOU.

In May 2009, after DBI assumed responsibility for the project, the government agreed in principle to build the warehousing and sell it to VFM under a revised MOU arrangement. DBI reserved the right to terminate the MOU if key parameters were not agreed by the end of June 2009.

The joint venture broke down, with VFM's partner obtaining a consent order preventing VFM from developing the facilities without its partner, or engaging in similar developments elsewhere. In August 2009, VFM advised the government that it had reached an in-principle agreement with its joint venture partner to settle the dispute, which involved VFM paying $6.95 million to its partner. DBI proposed using money set aside to assist tenant relocation to meet VFM's obligations under the settlement. The government agreed to the proposal. Ultimately, the government paid about $7.5 million to VFM out of the funding intended to assist market tenants to relocate.

In September 2009, the dispute was settled and the joint venture arrangement terminated. A month later, the MOU process was discontinued.

The discontinuation of the MOU process delayed the relocation, with almost two years lost and without warehousing needs being determined, without obtaining tenant commitment to trading floor tenancies, and without any work starting on the procurement of warehousing. The delays created the real possibility that the trading floor would be built and sit idle, waiting for the warehousing to be constructed.

The completion of the warehousing well after the trading floor is likely to result in:

- the warranty period for the trading floor expiring before it becomes operational, thereby impacting on DBI's ability to compel the builder to meet the cost of rectifying any construction defects, or
- DBI paying the contractor a fee to extend the warranty period.

The discontinuation of the MOU also cast doubt on the relocation, adversely affected the government's reputation, delayed tenant investment in the market and further worsened the government's relationship with the market community.

2.5.3 Risk management

While both DPI and DBI maintained a risk register, held risk workshops and prepared high-level risk plans, detailed risk management plans for the whole project were not developed until late 2011. For most of the project, risk management centred on identifying and rating risks with limited work on risk treatment. In addition, there was little documented rationale and analysis to support the rating of each risk, and monitoring and reporting was not sufficient for a project of this size and importance.

In 2010, DBI engaged a consultant to assist it to develop a risk management framework for the project. By August 2011, the department had prepared a risk management plan and now actively manages risk through weekly agenda items addressed at the project control group and project steering committee and in fortnightly reporting to the secretary.

Unresolved project risks

There are still a number of risks associated with the project, including:

- the state government has substantial demand (utilisation) risk on the trading floor, with no pre-leasing of tenants. This creates uncertainty around the financial viability of the project
- the potential reinstatement of the tenants' previous class action
- stakeholder risk—delays in completing the market, the lack of information provided to tenants and the dissolution of the MOU have significantly impacted on the government's relationship with tenants. In addition, some sections of the market want the transfer of the market operation and ownership to the market community and/or private sector. Until the government determines who will own and operate the market in the longer term there will continue to be uncertainty that will impact the support for the relocation from some sections of the market community
- the absence of clear, documented governance arrangements for the project
- the trading floor will be completed in 2013, but the proximity warehousing is unlikely to be completed until 2014–2015. This will result in the trading floor complex remaining empty for up to two years until the warehousing is constructed
- while the project received additional funding in 2011, until the lease agreements are signed with tenants, the government cannot be confident the project can be delivered within the new budget
- until the trading floor and warehousing tenancies are allocated and contracts signed with tenants, decisions made on funding the fit-out works, incentives for tenants to move and the likely cost of warehousing, the final cost of the relocation cannot be accurately determined. There are also some trading floor improvements that have not been included in cost estimates.

Many of these risks may be addressed as DBI develops its project planning documents, new committees are established to engage the market community, decisions are made on the allocation of the industry support package, and MMA signs pre-lease agreements with tenants.

2.5.4 Project time lines

The market was initially due to be operational in 2008. However, due to changes to the project delivery methods, scope and administrative arrangements, the trading floor will not be completed until 2013 and the warehousing not until 2014 at the earliest. An operational market is still at least two to three years away and at least six years late.

Following the state election in November 2010, the government asked DTF to undertake a review of the market relocation to assess whether the project should continue. The review and government response took some seven months and impacted on DBI's management of the project.

2.5.5 Project costs and funding

The project budget will be more than double the $300 million included in the 2004 business case. The revised budget represents an upper limit for government. The increase is due to:

- the addition of warehousing, which was originally to be financed by a private company with costs recovered through rental or sale to market tenants and users
- $116 million in additional costs for land purchases and construction
- $65 million for site preparation and project management costs being omitted from the original budget.

The government's direct contribution to the project costs has more than doubled from the $230 million included in the business case. MMA will fund $50 million of the government's contribution.

Originally, trading floor rents and service charges were to be used to repay project debt, with tenants renting or purchasing warehousing from private sector providers. Now that the state is providing both the trading floor and warehousing, it is not yet clear what the level of project debt will be and the amount of costs that will be recovered from the market community.

One of DPC's and DTF's concerns with the project since late 2006 was the absence of financial information of sufficient detail to indicate the likely cost of the project and the impact on market rentals. This situation started to be addressed in mid-2011 when DBI undertook detailed modelling to support its application for additional project funding.

Recommendations

1. The Department of Business and Innovation and the Department of Primary Industries should implement appropriate project management policies and procedures so that:
    - the options and risks associated with proposed changes to project scope, size, delivery methods and administrative arrangements are critically assessed and documented prior to actioning them
    - once changed, governance arrangements, business cases and project implementation and management plans are appropriately updated in a timely manner.

2. The Department of Treasury and Finance should provide more definitive guidance on better practice project management in its Investment Lifecycle Guidelines.

3 Stakeholder management

At a glance

Background

Stakeholder engagement and management is central to successful project delivery. The market community needed relevant, appropriate and timely information about the relocation.

Conclusion

Stakeholder management was not effective. A lack of communication with market tenants contributed to the delay in the relocation. Tenants still lack the basic information needed for them to make a decision on relocating.

Findings

- The business case identified relevant stakeholders and recognised that their management was critical to the success of the project.
- The Department of Primary Industries and the Department of Business and Innovation have not provided adequate and timely information to market tenants.
- Engagement with tenants has been inconsistent throughout the project. Consequently, tenants resisted the relocation and initiated legal action to protect their interests.
- Later in the project the Department of Business and Innovation better engaged the broader community.

Recommendation

The Department of Business and Innovation should:

- immediately provide further information to tenants, including finalisation of allocation of new space at the new market, to provide certainty and allow investment decisions to be made
- implement a clear and robust engagement strategy for the remainder of the project.

3.1 Introduction

Effective engagement with the market community was necessary to gain the support and meet the needs of market users.

Sound stakeholder management involves:

- identifying stakeholders and their needs
- developing stakeholder management strategies
- effective communication
- stakeholder engagement.

3.2 Conclusion

Stakeholders and their needs were initially identified and understood, but the stakeholder management was poor for most of the project.

While government agencies had a challenging task dealing with a diverse, politically astute group of market tenants, many of the problems impacting on the project were the consequence of poor stakeholder engagement for most of the project. Tenants still lack the basic information needed for them to make a decision on relocating.

The inability of responsible agencies to effectively manage stakeholders led to events that threatened the successful relocation of the market.

3.3 Stakeholder management and communications

The relocation needed tenants to support the move, however without sufficient information to enable them to make necessary business decisions, this support was unlikely to eventuate.

3.3.1 Identifying stakeholders and their needs

The project's purpose, goals and criteria for success need to be understood by stakeholders. To do this all stakeholders need to be identified, consulted and their needs understood. Stakeholders also have to be actively involved in the project, with their expectations continuously reviewed and managed.

The 2004 business case identified the major stakeholder groups as wholesalers, growers, flower sellers, buyers and unloaders, and:

- recognised the importance of gaining and maintaining tenant support
- acknowledged that market tenants were a diverse and politically astute group, not represented by a single organisation or person
- identified a number of issues critical to the market community's decision to move and developed strategies to address them.

The challenge for the Department of Primary Industries (DPI) was how to engage such a diverse collection of individuals and not let any individual or group unduly influence the relocation process to the detriment of others. The biggest and most dominant group was Fresh State.

In April 2006, representatives from the seven major market groups formed a strategic alliance. While the strategic alliance agreement allowed its members to negotiate for the retention of the current site, it acknowledged that the relocation was likely to be inevitable. Therefore the main concern for the alliance was to minimise the cost and impact of the move on market participants.

Factors important to the tenant’s decision to move

Market tenants range from small family businesses to some large vertically integrated organisations involved in farming and distribution across Australia. They operate in an environment of intense competition, where transactions occur quickly and are heavily dependent on price. Their ability to continue to operate their businesses at a profit was their main concern.

Factors important to the tenant's decision to move include:

- costs associated with the move
- market location
- access to space in the new market
- market operator
- market privatisation.

The 2004 business case identified these concerns, developed broad strategies to address them and allocated project funding, but the strategies were not followed.

DPI and later the Department of Business and Innovation (DBI) did not provide tenants with cost and other information that would enable them to assess the impact of the move on their business. This was the main reason for tenant resistance to the relocation.

At the time of this audit, tenants still lacked the basic information needed for them to make a decision on relocating. The market location has been determined and decisions on who will own and operate the market in the short term have been made. However, trading floor tenancy allocations and cost information required by tenants had not been provided at the end of 2011.

Costs associated with the move

Most tenants operate small businesses with high volumes and low margins, so they are cost sensitive. Tenant costs include:

- trading floor rentals and associated security, cleaning and power costs
- write off of leasehold improvements at Footscray Road not fully depreciated
- costs incurred to fit out their tenancies at Epping
- warehousing costs.

The tenants expected that this information would be available to them before they decided to move.

Market location

The Footscray market was a convenient central location for the market community. It allowed market participants to travel to the market late at night when the traffic was light and to return home against the city bound traffic in the morning.

As market participants travel from various locations across the state to the market, moving the market away from its current site was always going to suit some participants and disadvantage others. As a result, the preference of many market participants was to upgrade the Footscray site rather than relocate.

In February 2004, four potential sites were identified and presented to the market community. At this time, the community was asked to select its preferred location. There was strong support for the site on the northern side of the city.

Access to space in the new market

Tenants wanted roughly the same number of stores, stands and area in the new market as they had in the existing market. Anything less was seen as a threat to their business. The possibility of family businesses that had built up over years or even decades being lost in the relocation was unacceptable to them. Therefore the allocation of tenancies at Epping was of importance to them.

Market operator

The decision to retain government operation of the trading floor, under the Partnerships Victoria (PV) arrangement, was driven by the project objectives. The government considered that key aspects of the core trading facility needed to remain in government control in order to maintain a competitive marketing environment, prevent any undue influence by a particular market group and encourage new entrants.

While some members of the market community clearly wanted to operate the market, this was not the case for many others.

Privatisation of the market

Some tenants had raised the issue of market privatisation when the future of the market was being reviewed in 2004. The business case concluded that moving the market, while privatising it, would make the relocation more difficult and destabilise the industry. Privatisation of the market needed to wait until the new market was built and had been operating for a while.

The proposed design, build, finance and maintain strategy under the PV arrangement would have resulted in a private company owning the market for 25 years.

Market privatisation was clearly an objective of some of the larger wholesalers. However, there is no real evidence that privatisation—involving tenants funding the full cost of constructing the trading floor—was a significant issue for the majority of market participants.

While the appetite for an industry operated and owned market may not be as great as suggested by some tenants, uncertainty around this issue is still a concern for the market community.

3.3.2 Stakeholder management strategies

Once stakeholders are identified and their expectations understood, there needs to be a plan to actively involve them in the project, and mechanisms to deal with their issues.

There were a number of iterations of the stakeholder management plan, starting in November 2005. The plan was a high-level document that identified major stakeholder groups, key issues for each group, communication tools and approaches, key project milestones requiring consultation, and communication processes and broad strategies to manage stakeholders.

While the plan identified high-level stakeholder risks and issues, and included broad strategies, a more detailed plan was needed in order to guide the engagement and communications with stakeholders. This detailed plan should have distinguished between different market groups, outlined strategies to address each risk and assigned responsibility for the delivery of those strategies. Risks identified did not include the five areas of stakeholder concern referred to in the business case.

Many tenants were also seasoned negotiators and politically astute, who would fight vigorously to extract the best deal from the government. In these circumstances it was important that government agencies had a robust negotiation strategy and appropriate negotiating skills. DPI developed a negotiation strategy in late 2006, but the PV arrangement was abandoned before it was implemented, with the strategy becoming redundant.

The strategy was revised to reflect the memorandum of understanding (MOU) arrangement, but has not been updated to reflect the current arrangements. While far too late, DBI is currently developing this document.

3.3.3 Communications with stakeholders

Communications should be purposeful, continuous, clear and allow for stakeholder feedback to be addressed.

Communications with stakeholders was poor, with key information not getting to the wider community.

DPI initially put in place a number of mechanisms to manage communications with stakeholders, including:

- the establishment of a market consultation committee
- a communication strategy and associated plans
- confidentiality agreements.

However, these plans were not updated on a timely basis to reflect significant project and administrative changes, and lacked detail. In addition, only limited information on the relocation was getting through to the broader market community.

Market consultative committees

Consultative committees were established, but the number of committees and changes to them impacted on the effectiveness of stakeholder management.

The Market Consultation Committee (MCC) was created in early 2004 to represent the market community in the relocation and keep it briefed on the progress of the project. Its membership included representatives from the major groups within the market, DPI and the Melbourne Markets Authority (MMA). The MCC had five meetings and on-site consultations with the market community in early 2004 as part of the development of the business case.

Following tenant resistance to the relocation and the initiation of legal proceedings against the MMA, the Relocation Consultative Committee was established in early 2007 to re-engage the market community. It was chaired by DPI and its membership included MMA, and representatives of the strategic alliance. In February 2008, the committee's role changed from an advisory group to a decision-making body.

In September 2009, following the transfer of administrative responsibility for the project to DBI, MMA established the Market Relocation Overview Consultative Committee to provide project updates, feedback and advice to DBI and other relevant government agencies. Two other committees were created: the New Market Consultative Committee and the Proximity Warehousing Consultative Committee.

Recently, DBI has established a Market Advisory Committee and a New Epping Market Committee.

The continual introduction of new committees and changes to existing committees has adversely impacted on the effective engagement with the market community.

Communication strategy

Communication strategies were developed but set at too high a level and therefore lacked necessary detail.

DPI prepared a communication strategy for the period from May to December 2004. It was subsequently updated during the implementation phase of the project and submitted to the project steering committee in November 2005. The strategy outlined DPI's broad approach to communications and included communication objectives, the target audience, key messages and communication tools. The strategy outlined 10 major implementation processes, which included:

- the development of a design diagram and master plan
- pre-leasing/lease negotiation and lease agreements
- the PV procurement process
- fit-out.

The strategy envisaged the preparation of complementary communications activity plans for each of the 10 phases identified. These would detail audience specific activities and messages, time lines and budgets for each phase. However, except for the design activity plan, developed in January 2006, no other plans were submitted to the project steering committee. This audit has not been able to locate any other plans.

In February 2007, a new communication strategy was developed. At this time the strategic alliance and the government were in talks to develop the MOU. The strategy recognised the need to re-engage with the strategic alliance and identified a number of issues that needed to be considered in rebuilding relations with the market community.

The strategy included a series of key messages and tactics to manage the market community, but it did not contain the detailed strategies, time lines, resources, assignment of responsibilities, or an evaluation approach, normally included in a communication strategy. As with previous communication strategies, the strategy did not identify the needs and concerns of each sub-group within the market community, or include plans to engage market tenants on an individual basis.

With the discontinuation of the MOU, there was a need for a revised communications strategy. DBI is currently developing such a document.

Confidentiality agreements

DPI's use of confidentiality agreements as part of its communication strategy adversely impacted on the flow of information about the project to the market community.

Representatives on the MCC and strategic alliance were required to sign confidentiality agreements. DPI explained that the aim of the agreements was to allow redevelopment options and strategies to be discussed in an open and frank manner and to minimise the risk of negotiations occurring through the media. However, letters sent to the government from two MCC representatives, raised concerns with the agreements and suggested that they were preventing the communication of the MCC's deliberations and decisions to the broader market community.

The 2006 agreement, developed by the members of the strategic alliance, also included confidentiality clauses that restricted the distribution of information acquired by alliance members from being divulged to third parties without the written consent of the alliance. These agreements also restricted the flow of information about the project to the broader market community.

3.3.4 Engaging the market community

Engagement with the market community was initially set at too high a level. Later in the project DBI better engaged the broader market community.

If the project was to go smoothly, there needed to be stakeholder acceptance and buy-in to the relocation.

The initial reaction of the market community to the proposed relocation was a reluctance to move. In 2004, the market peak bodies indicated to the government that they wanted the market to stay at Footscray Road. If they had to move, they first wanted to understand the reasons for the move.

The broader market community were consulted on the site selection and initial conceptual design and there was some communication to the broader community through MMA's Market Fresh News. However, DPI's strategy mainly involved engaging the market peak bodies and relying on them to communicate with the broader market community.

As the project progressed there were concerns around the extent to which some stakeholder groups represented their broader constituency and the effectiveness of the transfer of information from the peak bodies to their constituents. In these circumstances, it was important to have mechanisms to engage the market community directly. However, based on feedback from tenants and MMA, and correspondence received by DPI stating that peak bodies were not able to communicate with tenants due to the existence of confidentiality agreements, the broader community were never sufficiently engaged in the project.

In this environment it was easy for some sections of the community to galvanise support against the planned relocation.

On the transfer of administrative responsibility to DBI, the department established more effective processes to engage the broader market community, including:

- setting up a stall in the market to respond to market participant queries
- DBI and MMA staff spending time walking the floor engaging the market community
- displaying the project plans in the market
- arranging for tenants to visit and inspect the new Epping site.

This broader stakeholder engagement initially had a positive impact on DBI's relationship with the market community.

Lack of information about the need for the relocation

Major concerns for the market community were:

- the mixed messages coming from the government about the move
- the government's inability to honour its commitments to keep the market community informed about decisions impacting on them, and to provide them with the justification for these decisions.

The government and MMA believed that there were good economic, commercial, work safety and efficiency reasons for the relocation and offered to share this information with the market community. The frustration for the market community was that this information was never provided to them.

In May 2006, the strategic alliance asked the Minister for Agriculture to provide the 2002 project feasibility study, business case and a report on MMA roles and responsibilities. In its response, DPI indicated that it had no knowledge of the feasibility study and the business case would not be provided as information it contained was commercially sensitive. Agreeing to make this information available to the market community, then deciding not to provide it undermined the government's relationship with market participants.

Providing the documents requested, or extracts from these documents with any sensitive commercial information and government strategies removed, would have:

- helped establish an effective relationship with the market community
- removed a key issue used by some tenants to oppose the redevelopment.

Tenancy allocation process

A critical concern for tenants was access to space in the new market that was similar in size and nature to the one they had at Footscray Road. Long-term tenants at Footscray believed that they should get preferential treatment in the allocation of stores at Epping.

During 2006 tenants continued to seek assurance from DPI that they would be guaranteed a tenancy in the new market. The uncertainty around surety of tenure in the new market was a major reason for the strategic alliance deciding not to continue to support the relocation. DBI is currently working with tenants on a process to allocate tenancies at Epping.

Recommendation

3. The Department of Business and Innovation should:
   - immediately provide further information to tenants, including finalisation of allocation of new space at the new market, to provide certainty and allow investment decisions to be made
   - implement a clear and robust engagement strategy for the remainder of the project.

4 Trading floor procurement

At a glance

Background

Sound procurement is necessary to best meet the state's interests. This includes achieving value-for-money in procurements and promoting confidence in commercial dealings by demonstrating fairness and transparency.

Conclusion

Major Projects Victoria's (MPV) procurement process was not demonstrably fair and it is likely the government paid more for the trading floor than it should.

Findings

- Over emphasis on design and MPV's cost adjustment process cast doubts on the fairness of the process.
- Probity was not well managed.
- MPV cannot demonstrate that the procurement achieved value-for-money.

Recommendations

Major Projects Victoria should:

- revise its procurement policy and operating procedures to align with contemporary better practice in public sector purchasing
- provide regular probity training for all staff involved in procurement activities.

The Department of Treasury and Finance should:

- require agencies to obtain related interest declarations from project staff for each procurement project on which they work
- develop processes to assess the quality of service of probity practitioners.

4.1 Introduction

Public sector procurements should comply with government policies, legislative requirements and guidelines, and be conducted in a demonstrably fair and impartial manner. They should be managed to:

- obtain the goods and services required to meet the identified need
- achieve value-for-money.

The legislation, policy and guidance relevant to this project are:

- the *Project Development and Construction Management Act 1994*
- Ministerial Direction No. 1 Tendering Provisions for Public Construction.

The Victorian Government Purchasing Board policies and guidelines on procurements set minimum standards for the procurement of goods and services in government departments and agencies. While these guidelines do not apply to construction projects, they generally demonstrate better practice.

The stages of procurements generally involve:

- planning
- market engagement
- registration of interest/expression of interest
- request for tender
- tender evaluation
- negotiation and appointment of a preferred tenderer.

4.2 Conclusion

The broad procurement strategy for the project was reasonable. However, procurement management planning lacked detail and was not timely.

It is likely that the trading floor, when operational, will provide the environment for an efficient, competitive and accessible market that meets the needs of the market community. However, poor probity management resulted in a procurement process that did not demonstrate fairness or appropriate management of conflicts of interest.

In addition, the evaluation process used and poor decisions made during the procurement are likely to result in the government paying more for the trading floor than it should.

4.3 Procurement stages

In October 2007, Major Projects Victoria (MPV) developed a procurement strategy for the trading floor that was revised in May 2008. The strategy involved engaging a private sector company under a design and construct contract to build the trading floor. The procurement strategy was reasonable for this project.

A project management plan for the trading floor delivery was prepared in April 2010, after site works had started, and included documents prepared by, or in conjunction with, the successful tenderer. While the plan provided a strategic approach to the construction of the trading floor, it was not timely, and in the absence of an overarching project implementation plan, the trading floor construction was not coordinated with the rest of the project.

4.3.1 Procurement governance

MPV appointed a project director and assembled a project team to manage the procurement and construction of the trading floor. MPV reported to the Minister for Major Projects.

4.3.2 Market sounding

Better practice requires agencies to gather information on the capacity and competition in the market, and the attractiveness of the offering. This information enables the purchasing agency to develop a strategy that will achieve the best outcomes for the expenditure of public money.

As construction of the trading floor was a significant project, involving relatively simple and straight forward structural systems and construction methodology, both the Department of Primary Industries (DPI) and MPV considered that it would be an attractive proposition for contractors. With the effects of the global economic crisis slowing down the construction industry, strong interest from both medium and large contractors was expected.

However, DPI and MPV did not conduct an analysis of the potential market for the contract—the best way to conduct the procurement or identify potential contractors for the work—prior to undertaking the procurement. This analysis would normally be included in the procurement strategy.

There was a general awareness of the project in the marketplace prior to the registration of interest process.

4.3.3 Registration of interest

In November 2008, MPV asked all pre-qualified firms on the government's construction services register, with an average turnover greater than $100 million, to indicate their interest in registering for the project. Eleven registrations were received from the 19 eligible companies. MPV assessed each of the submissions against pre-established criteria and eight firms were selected to proceed to the expression of interest stage.

4.3.4 Expressions of interest

In December 2008, DPI provided each of these eight companies with a draft version of the site works plan and a design functional brief and allowed them to view planning, environmental and heritage documents held at MPV's office. Interested companies were asked to submit their expressions of interest by 10 February 2009. Seven companies responded and their responses were assessed against pre-established criteria, rated and ranked.

In compliance with the Ministerial Direction No. 1, three companies were short-listed for the tender.

At the end of the expression of interest process, the procurement was progressing as intended. MPV had identified three capable and available construction companies who were interested in the project.

4.3.5 Withdrawal of tenderer

The three short-listed companies received a briefing session prior to the release of the request for tender (RFT). The day after the briefing session one of the companies advised MPV of its intention not to submit a tender.

This created a risk that two compliant competitively priced tenders, required to create competitive tension, would not be received. As the RFT had not been issued, MPV had an opportunity to delay the tender process and re-assess the situation before proceeding.

After seeking advice from the probity auditor and reviewing the options to proceed with or defer the issue of the RFT, MPV recommended to the project steering committee that the remaining two companies be asked to submit tenders. This was based on MPV's view that:

- the three short-listed tenders were the stand out companies from the expression of interest stage and there was a significant gap between them and the rest of the field
- issuing an RFT to other companies would unreasonably delay the tender and increase costs.

With the global financial crisis adversely affecting the Victorian economy, the government wanted to start projects that would generate construction activities to stimulate the economy and were ready to start. MPV's focus was on the construction of the trading floor and it wanted to progress the project.

4.3.6 Request for tender

The RFT was issued to two companies on 1 May 2009.

In the period May to July 2009, MPV offered one guidance and three design workshops to help the companies better understand MPV's requirements and the procurement process. The company that won the tender attended all four workshops, the other company attended the first and the last.

It is unclear why one company decided not to attend all of the design workshops offered which had the potential to give its competitor an advantage. It is reasonable to expect MPV to have identified companies not attending all of the design workshops as a risk to the tender process and to have developed strategies to address this risk.

The audit found no evidence of MPV:

- identifying this risk and assessing the effect of companies not attending all workshops
- confirming the attendance of companies prior to the conduct of the workshops
- contacting the tenderer that did not attend to understand why.

Both companies submitted tenders by the due date.

4.3.7 Tender evaluation

MPV established three groups to assess the tenders:

- **Design Evaluation Group**—this group had eight members and evaluated each tender against the design evaluation criteria.
- **Commercial Evaluation Group**—this group had five members and assessed the capability and suitability of each company's key personnel, their proposed program and methodology.
- **Evaluation Control Group**—this group had four members that reviewed the findings of the design and commercial evaluation groups, assessed the value-for-money and risk profile of each tender and recommended a preferred supplier.

With the capability and availability of prospective tenderers assessed in the expressions of interest phase, the evaluation of tenders focused on design and price.

Trading floor design

The procurement strategy noted that the proposed delivery method would transfer the project design risk to the contractor and make management of the construction easier, with one single point of responsibility for the whole project. It was expected that the contractor's price would contain a loading to cover the design risk.

When design material was provided at the expressions of interest stage both tenders received the same rating.

In the RFT, tenderers were asked to provide very detailed plans, drawings and documentation in their tenders. Each tender was scored against four non-price criteria, with one criterion—design—consisting of 10 subsidiary criteria. The trading floor design criterion was given a weighting of 72.5 per cent of the evaluation criteria. The successful tender was assessed as being considerably superior in this respect.

The evaluation found that the unsuccessful tender did not comply with the contractual requirements, demonstrated poor understanding of the specification design requirements and the design proposed was not adequately supported or costed. The company's decision not to attend all the design workshops was a likely contributor to this outcome.

Was the emphasis on design appropriate?

In August 2004, DPI engaged a design consultant to work with the market community to develop a functional design for the market. Part of the reason for this was DPI's desire to obtain tenant buy-in to the market design and get them to sign pre-lease agreements before the construction of the trading floor began. When the Department of Business and Innovation (DBI) took over administrative responsibility for the project in 2009, DBI continued to use the consultant.

During the five-year engagement, the consultant prepared:

- design objectives, 12 evaluation criteria and the advanced concept design
- functional and technical requirements (FTR) for the market and the tender documentation relevant to the design. The FTR is the key document that provides the basis for the design of the project
- a preliminary layout for the market.

By the time the procurement strategy was produced, the design had been developed to the concept design stage consisting of eight project drawings and a 37-page FTR. Given the significant amount of design work undertaken by the design consultant, the benefits from transferring the design risk to the contractor were reduced.

Tenant representatives, specialist consultants and DPI staff spent five years developing a design brief and an advanced concept for the project, referred to in the procurement strategy as a relatively simple design. In these circumstances, it is difficult to understand why:

- tenderers were asked to include such detailed design documentation in the tender. Asking for this level of detail appears excessive. It adds to tender preparation costs and the cost of the assessment and may have deterred companies from tendering
- so much importance was placed on project design in the evaluation process.

In addition, despite contracting with two separate organisations to design the trading floor, significant costs were incurred by the state as a result of design changes made after the successful tender was announced. This is despite a procurement strategy that was intended to transfer design risk to the design consultant and the contractor.

Tender price adjustment process

Selection of the preferred tender must reflect an overall assessment of the value-for-money of each tender, taking into account the price submitted and scores against other qualitative criteria.

Risks may be considered, and will often be reflected in risk-adjustments to the tender price or criteria scores, or both. These adjustments are made after tenders have been evaluated and used to reflect non-compliance with contract conditions, scope matters to be resolved in negotiations, or the risk of non-delivery.

However, MPV made adjustments to the tender prices beyond these. Tender prices were adjusted following a comparison of cost elements against an indicative costing developed by a consultant engaged by MPV. This was an attempt by MPV to compare both tenderers prices for the same scope of work. It assumed, without adequate validation, that the cost of specific components of the trading floor construction priced below the consultant's estimate reflected the tenderer's underestimation of the work involved.

The price bid by the unsuccessful tender was $40 million less than the successful tender. However, after adjustments were made, its bid price was no longer considered to be a point of differentiation.

The MPV assumption about the detailed costings provided by the unsuccessful tenderer failed to recognise that:

- there may have been sound commercial reasons for the tenderer to submit a low price
- the tenderer appeared to have included high contingencies in its bid rather than fully cost-specific components.

The process was also applied inconsistently:

- Many components of the unsuccessful tenderer's costs were increased, including cases where the tendered cost was already above the consultant's estimate. Only one component of the successful tender's costs was increased, despite a number being below the consultant's estimate.
- There was a tender clarification process involving both tenders that included a number of questions around costing. This was to clarify specific items included in the tenders. However, MPV did not seek clarification on many of the cost adjustments made to the unsuccessful tenderer's bid price. Even where the unsuccessful tenderer was asked to explain its low price for a component of the work, MPV made a significant adjustment to its tender price despite the tenderer indicating that it would complete the work per the specification at the price quoted in its tender.

The price adjustment process was not transparent and the evaluation report did not demonstrate that the successful tenderer represented better value-for-money.

4.3.8 Approval of preferred supplier

On 25 September 2009, following the completion of the evaluation process, the evaluation control group recommended that contract negotiations commence with the successful tenderer. This recommendation was endorsed by MPV's executive director and the project steering committee.

The audit found that:

- only three of the five members of the project steering committee signed off on the preferred supplier
- representatives from the Department of Treasury and Finance and the Department of Premier and Cabinet did not attend the project steering committee's endorsement meeting due to their lack of involvement in the procurement process.

On 2 October 2009, DBI announced its preferred builder.

Revised tender requirements

In June 2009, following the release of the RFT, DBI continued to consult with the market community. During these meetings, some members expressed concern over key aspects of the design, including the 'T' shape trading floor.

In October 2009, an alternate 'E' shape trading floor design was proposed and accepted by the design consultative committee and endorsed by DBI. An alternative design brief was developed to reflect the change in shape and in response to the concerns.

On 6 October 2009, prior to the signing of the contract with the successful tenderer, DBI asked the company to submit new design, engineering and costing information to reflect the change in the trading floor design. This also included a central refrigeration plant (identified as an option in the original tender response, but rejected) and additional works.

The successful tenderer's revised offer was over $30 million more than the company's original tender price bid.

On 17 March 2010, MPV (on behalf of the state) signed contracts with the successful tenderer to build the trading floor facility together with the hardstand and loading and unloading areas and miscellaneous buildings, civil platform for warehousing, site drainage and wetlands.

4.4 Procurement conduct

The success of government procurements is measured by the extent to which:

- goods and services acquired meet the needs of users
- the procurement process is demonstrably fair
- the acquisition represents value-for-money.

4.4.1 Meeting the needs of market participants

It is not possible to say conclusively that the Epping market will meet the needs of the market community, until it is operational. However, the market community have worked closely with DPI and DBI, a professional design consultant and MMA over many years on the design of the trading floor. DPI also spent significant time and resources on researching and visiting other markets around the world. Through this process it is likely that the trading floor will meet the needs of market participants and provide an efficient and effective trading environment for them to conduct their business.

4.4.2 Demonstrating probity

Probity was not well managed in this project and is not consistent with better practice.

In both the public and private sectors, a great deal of importance is placed on adopting appropriate processes for the procurement of goods and services. A key goal for all procurers is to maintain appropriate standards of fairness, transparency and process integrity.

Processes to manage perceived and actual conflicts of interest and other probity issues need to be robust, transparent and consistently applied.

Probity governance and planning

DPI prepared a probity plan for the project and engaged a probity auditor to provide advice and assurance on the conduct of the procurement.

Reports provided by the probity auditor on the registration of interest, expressions of interest, and the tender evaluation process, state that in his opinion the evaluation process was undertaken in line with probity principles including identifying and resolving conflicts of interest.

The reports by the probity auditor contain no analysis of key probity issues that arose during the procurement, thus providing only limited assurance.

The probity plan was created in October 2005, and was substantially revised in September 2008 to reflect the changed memorandum of understanding arrangements. However, it was not updated to reflect further significant changes to the project scope, delivery method, project staff and governance arrangements.

There is also no evidence that:

- the reviewed plan was approved by the project sponsor or project steering committee
- compliance with the plan was assessed by the probity auditor or any other staff member during the project.

The audit found that project management staff were not fully aware of the high standard of probity required for large public sector procurements and the importance of good probity. Other concerns with probity controls were:

- the responsibility for project probity was not assigned to a senior staff member
- there was no regular reporting on probity issues to the steering committee
- that apart from the probity auditor briefing the evaluation team on 17 August 2009, no other probity briefings or training were provided
- that record keeping was inadequate, with insufficient documentation to support actions and decisions made during the project.

Conflicts of interest

Conflicts of interest arise when persons are influenced, or appear to be influenced, by personal interests when doing their job. Such conflicts are likely to create the perception of bias and result in poor procurement outcomes.

The Victorian Government Purchasing Board *Policy for the Conduct of Commercial Engagements* requires agencies to develop processes to identify conflicts, assess the materiality of the interest or relationship and take action to address the conflict.

The procurement probity plan included guidelines for managing conflicts of interest. These guidelines only address conflicts assessed as ‘real’ and provide no guidance on the identification and management of potential or perceived conflicts of interest. In this situation, it is unclear how potential conflicts can be assessed when there is no process for identifying them.

The conflict of interest guidelines attached to the probity plan (prepared by DPI) required project team members to sign a form acknowledging their code of conduct responsibilities and a declaration that they had no conflicts of interest. External advisors were also required to sign conflict of interest statements.

However, prior to 2011, MPV procedures did not require staff to sign declarations. MPV considered that the Victorian public sector code of conduct requirement that all staff avoid and report conflicts of interest was sufficient. As a result, MPV did not require internal project staff to sign conflict of interest declarations for this project.

This is not adequate for large or risky projects, as it is the project steering committee and/or project sponsor that must be satisfied that conflicts of interest have been identified and managed. Relying on individuals to make their own assessment of whether or not a conflict of interest exists, particularly where there is poor understanding of probity requirements, is inadequate. Best practice requires project staff to declare all related interests, with the project management responsible for assessing whether a conflict exists and documenting this assessment and, where necessary, any strategies to address it, in each instance.

Conflict of interest management

Once identified, government agencies often use one or more of the following strategies to manage a conflict:

- introducing oversight controls, such as separate reviews of decisions made by the person with the identified conflict
- having more than one person involved in the decision-making process
- establishing other controls to prevent the conflict from resulting in bias.

These controls endeavour to influence the actions of the person with the conflict and/or reduce their influence over the decision-making process. However, perceptions of bias must also be managed effectively.

The audit found a number of related interests that had the potential, if not adequately managed, to cast doubt on the integrity of the procurement process:

- MPV's project director was the chair of the Design Evaluation Group and a member of the Evaluation Control Group. He had previously been employed by the successful tenderer for 10 years prior to his joining MPV less than three years before the tender began. While his prior employment was well known to MPV, his prior involvement with the successful tenderer created a perceived, if not an actual, conflict of interest. This potential conflict was not documented and not considered by MPV to be significant enough to warrant being assessed.
- Senior MPV staff involved in the procurement attended an industry award presentation with the successful tenderer during the tender evaluation process. The award related to another project managed by MPV where the successful tenderer was receiving an award. In such circumstances, attendance at the function, or any event where tenderers were likely to be present, should have been avoided. Despite the risks associated with attending this event being raised by the probity auditor, MPV decided to attend. This demonstrates a lack of understanding of probity by the procurement team.

Access to information

If the market has access to information that could be perceived as giving a potential supplier an advantage in the selection process, then potential suppliers are likely to respond by not tendering or not expending a lot of resources on the preparation of their tender.

The audit identified two examples where the actions of MPV may have had this effect.

Involvement of the successful tenderer in project planning

Prior to going to market, MMA and MPV engaged the company that subsequently won the tender to undertake early research and options analysis for the project. The company was involved in the design planning phase, assisted DPI to assess the redevelopment options, and provided input into the business case.

When DPI became aware this company was considering bidding for the project, it contacted the company to discuss the matter. The probity auditor advised the company that it should restrict the access of its bid team to information obtained during the consulting work. Assurance was subsequently provided by the company that no staff engaged in the planning work would be involved in any potential tender and the tender team would not access previous material obtained or provided in the earlier consulting work.

This action is ineffective as the arrangement is very difficult to verify, and does not address the perception of unfair advantage among other potential participants. A better approach would have been to provide all the information available to the company prior to the tender to all other parties, and allow sufficient time for those parties to understand and query that information. If this was not feasible, and in the absence of a demonstrated compelling case, the company should have been excluded from the tender.

Additionally, the environmental consultant used by DPI in the planning process was also part of the team that successfully tendered for the construction of the trading floor. This created another perceived conflict of interest.

The problem with perceived conflicts of interest is that they can influence the decision of companies to tender and their behaviour during a tender. It is not possible to know what impact, if any, the potential conflicts of interest had on tenderers as no assessment was undertaken by MPV.

Workshops provided to tenderers

The RFT offered the two short-listed tenderers a positive guidance workshop and up to three design workshops in designated weeks. The workshops included a presentation by MPV on the tender requirements and process, and questions and answers in line with MPV’s interactive tender process protocols.

The workshops were held separately with each tenderer. The successful tenderer attended all four workshops offered, the unsuccessful tenderer attended the positive guidance workshop and one design workshop.

A sound practice in tendering is to establish tenderer engagement processes that result in each tenderer being provided with consistent information on the tender requirements and tender process at the same time. Holding separate workshops for each tenderer makes it difficult to ensure that the same information is provided to each tenderer. In these circumstances, the need for separate workshops should be assessed and if found necessary, additional processes need to be taken to assure consistency and fairness.

Additional processes would include the attendance of the independent probity practitioner at each workshop and/or the taping of discussions. The probity auditor was only present for part of one of the workshops and the discussions were not taped.

4.4.3 Demonstrating value-for-money

MPV did not demonstrate that the trading floor procurement provided value-for-money.

MPV's evaluation procedure states that the outcome of the evaluation process was to be the selection of the tender that provides the best value-for-money. This was to be determined by taking into account:

- the relative ranking of tenders against other tenders after each tender has been assessed against the evaluation criteria
- the tender price and price structure for the full contract period, compared to other tenders and MPV's budget
- any risks associated with entering into a contract with the tenderer.

The only way to be satisfied that purchases provide value-for-money is to acquire them through a competitive process. In construction contracts this involves having two or more capable, available suppliers submit fully costed tenders that meet the specifications and are competitively priced.

Based on the MPV evaluation, the tender only attracted one fully costed, adequately supported, reasonably priced tender that met MPV's contractual requirements. As a result, the tender process failed to establish sufficient competitive tension to achieve value-for-money. This was compounded by the magnitude of scope changes after selection of the preferred tenderer.

After significant changes to the specification, MPV agreed to the successful tenderer's revised tender and as a result will pay the company an additional $31 million—more than 10 per cent of the price tendered.

The revised offer was reviewed by a project cost consultant engaged by MPV to verify that the rates quoted by the tenderer for the additional work were consistent with those in the original tender. The successful tenderer also allowed MPV access to its records to verify the rates charged. MPV considers this process provided it with assurance that the additional cost represents value-for-money.

Obtaining access to the financial records of the supplier can be used to provide assurance that the cost of additional goods and services, acquired outside the tender, are consistent with the original tender. But it does not guarantee value-for-money if the supplier's costs are higher than its competitors.

Recommendations

4. Major Projects Victoria should:
   - revise its procurement policy and operating procedures to align with contemporary better practice in public sector purchasing
   - provide regular probity training for all staff involved in procurement activities.
5. The Department of Treasury and Finance should:
   - require agencies to obtain related interest declarations from project staff for each procurement project on which they work
   - develop processes to assess the quality of service of probity practitioners.

Appendix A.

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 Business and Innovation, the Department of Primary Industries, the Melbourne Market Authority, the Department of Premier and Cabinet and the Department of Treasury and Finance with a request for submissions or comments.

Responses were received as follows:

Further audit comment:

The submission 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.

Submissions and comments received

RESPONSE provided by the Secretary, Department of Business and Innovation

Department of Business and Innovation

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RECEIVED
07 MAR 2012
VICTORIAN AUDITOR-GENERAL'S OFFICE

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

Dear Mr Pearson

AUDIT REPORT - MELBOURNE MARKETS REDEVELOPMENT PROJECT

Thank you for your letter of 24 February 2012 inviting comments or submissions on the proposed Audit Report - Melbourne Markets Redevelopment Project.

While not in agreement with all of the comments made in your report, the Department of Business and Innovation (DBI) acknowledges the work involved in the audit report, in particular the difficulty of the task in reviewing a project that over its life has been the administrative responsibility of two departments, involved three different delivery models and requires interaction with over 3,000 market businesses.

In relation to this project, DBI's focus is to deliver a modern market facility that will provide growth opportunities for current market businesses. To this end, DBI has been engaging with market businesses on matters that will facilitate their investment decisions in the new market. A program of consultation on key commercial issues is underway beginning with comments being sought from market participants on arrangements for the allocation of stores and stands in the new market.

Regarding governance arrangements, DBI has concluded a review of the internal governance arrangements for the project. The recommendations of the review that are supported by the Departments of Premier and Cabinet and Treasury and Finance are currently being implemented.

In relation to the VAGO comments on the procurement practices of Major Projects Victoria (MPV), the Department seeks to achieve the best commercial outcomes whilst maintaining high standards of probity in all major project activity. To this end the Department does not fully accept VAGO's conclusions regarding fairness and value for money of the trading floor procurement.

Major Projects Victoria's procurement followed a documented process that had been developed in accordance with established guidelines. This process culminated in the selection of the better of two compliant tenders, both of which were priced below the pre-tender estimate. On this basis, even if VAGO considers that this has not been demonstrated, it is reasonable to conclude that fairness and value for money have been achieved.

State Government Victoria

RESPONSE provided by the Secretary, Department of Business and Innovation – continued

Nevertheless work is already substantially completed to refresh and update MPV's policy and procedures. This includes introducing more rigorous processes for identifying and managing potential conflicts of interest, ensuring that all documents used by MPV in its procurement functions more clearly outline MPV's intended approach to dealing with tenders, and providing formal training to MPV project officers on the application of probity principles to procurement.

Yours sincerely

·7/03,

HOWARD RONALDSON
Secretary

RESPONSE provided by the Secretary, Department of Primary Industries

Department of Primary Industries

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09 MAR 2012
VICTORIAN AUDITOR-GENERAL'S OFFICE

Our Ref: SI007661

Mr D.D.R Pearson
Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE VIC 3000

Dear Mr Pearson,

AUDIT ACT 1994, S16(3) - PROPOSED AUDIT REPORT MELBOURNE MARKETS REDEVELOPMENT

Thank you for the opportunity to reply to the final report. The Department wishes to make the following comments in accordance with section 16 of the *Audit Act 1994*.

1. **Stakeholder Engagement**

VAGO's view is that stakeholder management has not been effective. This resulted in delays in communication with market tenants of their future rents. DPI's view is that it had an effective and well managed stakeholder engagement strategy which was well implemented. DPI was unable to fully provide the tenants with financial information (rents and other fees) within their expected time frames. This is because DPI needed to fully and accurately assess the capital and operating costs in order to determine the rents and fees of the market before it could communicate the information with the market community.

2. **MOU**

VAGO's view is that the shift from a Partnerships Victoria model to an MOU model for the market community to deliver parts of the project created significant risks for the project. VAGO's view is that this shift in strategy was done without proper assessment of the options and associated risks. DPI's view is that the process by which DPI would engage with the market community formed part of the MOU. This process was used to assess risks and conduct due diligence, as and when binding contracts were being developed and negotiated. This model was attractive to the market participants because they had an option to buy the market. Full risk assessments were conducted at the time in accordance with DPI project management policies and procedures.

Privacy Statement
Any personal information about you or a third party in your correspondence will be collected and protected under the provisions of the ***Information Privacy Act 2000****. It will only be used or disclosed to appropriate ministerial or departmental staff in regard to the purpose for which it was provided, unless required or authorised by law. Enquiries about access to information about you held by the Department should be directed to the Manager Privacy, Department of Primary Industries, GPO Box 4440, Melbourne, 3001*

Victoria The Place To Be

For more information about DPI visit the website at www.dpi.vic.gov.au or call the Customer Service Centre on 136 186.

RESPONSE provided by the Secretary, Department of Primary Industries – continued

3. **Project and Risk Management**
VAGO's view is that changes to the project scope and method of delivery were not adequately followed by updates to governance arrangements, project management plans, business case and financial information. DPI's view is that governance arrangements and project plans were regularly updated and detailed financial figures produced.

Yours sincerely,

pe **Jeff Rosewarne**
Secretary

9 / 3 / 2012

Auditor-General's response to the Department of Primary Industries

Stakeholder Engagement

The Department of Primary Industries' comments relate specifically to stakeholder engagement around rents and other charges. Contrary to the department's assertion, the audit findings relate to stakeholder engagement in a broader sense across the life of the project. The basis for our findings and conclusions are set out in section 3.3.3.

MOU

As set out at section 2.5.2, the audit view is that rigorous assessment of this option should have occurred prior to embarking on this course of action, and that an assessment at the completion of the project is too late.

Project and Risk Management

The departmental view does not accord with the audit evidence summarised at section 2.5.1.

RESPONSE provided by the Chairman, Melbourne Market Authority

9 March 2012

Mr D D R Pearson
Auditor General
Victorian Auditor General's Office
Level 24, 35 Collins Street
Melbourne VIC 3000

Dear Mr Pearson

Final Audit Report : Performance Audit Report *Melbourne Markets Redevelopment Project.*

The following is the response of the Melbourne Market Authority (MMA) to the Final Audit Report *Performance Audit Report Melbourne Markets Redevelopment Project*.

The MMA notes the recommendations in the VAGO Audit report and advises that, to the best of its knowledge, it reflects the MMA's involvement in the project activities to date.

Thank you to the VAGO audit team for its work in this regard.

Yours faithfully

Neil Lowe
Chairman
Melbourne Market Authority

RESPONSE provided by the Deputy Secretary, Department of Premier and Cabinet

Department of Premier and Cabinet

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Mr Des Pearson
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Dear Mr ~~Pearson~~ Des

***Audit Act 1994*, s16(3) – Proposed Audit Report on Melbourne markets redevelopment**

Thank you for the opportunity to comment under section 16(3) of the *Audit Act 1994* on the proposed Audit Report on Melbourne Markets Redevelopment Project.

The Department of Premier and Cabinet (DPC) welcomes the report and recognises that it raises a number of important lessons for government on how to better deliver major projects in the future. I do not, however, wish to make any specific comments on the draft report.

I would also like to acknowledge the efforts of your Office in working closely with DPC throughout the conduct of this audit.

Should you have any further questions, the contact at DPC regarding this project is Mr Peter Beaumont, Director, Resources and Infrastructure Branch (9651 5773 or Peter.Beaumont@dpc.vic.gov.au).

Yours sincerely

Pradeep Philip
Deputy Secretary

Your details will be dealt with in accordance with the *Public Records Act* 1973 and the *Information Privacy Act* 2000. Should you have any queries or wish to gain access to your personal information held by this Department please contact our Privacy Officer at the above address.

State Government Victoria

RESPONSE provided by the Secretary, Department of Treasury and Finance

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Mr D D R Pearson
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8 March 2012

Dear Mr ~~Pearson~~ Des

Performance Audit – *Melbourne Markets Redevelopment*

Thank you for the opportunity to comment on the proposed report for the Melbourne Market Redevelopment Project (Project). I appreciate your taking into consideration the exclusion of some commercially sensitive information. I would like to make the following comments on the proposed report in preparation for its tabling in Parliament.

Recommendation 2

The current Investment Lifecycle Guidelines recognise that Business Cases are a "living document" requiring periodic review and update. DTF is currently reviewing these Guidelines following the introduction of High Value / High Risk requirements. This review will consider guidance on better practice project management.

Recommendation 5

A requirement of probity in Government contracting includes identification and resolution of conflicts of interest. Conflicts of interest include both perceived and actual conflicts of interest, which could be expected to include declarations of related interests that require identification and resolution.

There is a Whole of Victorian Government (WoVG) Panel arrangement, the Probity Practitioner Services State Purchase Contract, for the appointment of probity practitioners by departments and agencies. DTF and each Budget Sector Agency are mandated to use this WoVG panel arrangement (Panel) for all probity advisory and probity auditing requirements. Probity practitioners on this Panel were selected based on the necessary skills and demonstrated ability to perform the services. A Budget Sector Agency can engage a probity practitioner to assist with a range of government transactions including building and construction.

State Government Victoria

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

Under the Panel, DTF requires that all Budget Sector Agencies assess the performance of each probity engagement provided for work over the value of $2,000. This allows DTF to monitor and improve the quality of service provided by the Panel and also provides each probity practitioner with constructive feedback. DTF reviews these quarterly in conjunction with annual probity practitioner reviews.

Ultimately, responsibility for probity outcomes, management of conflicts of interests and fulfilment of the scope of probity services remains the responsibility of Budget Sector Agencies and their project teams. The Panel supports the Victorian Government's objectives of ensuring fairness, openness and transparency in Victorian Government transactions.

DTF continues to support ongoing enhancement to WoVG processes for better practices in a range of project delivery areas including project management and probity.

If any further clarification is required or you would like to discuss the contents of this letter, please contact our nominated officer, Jason Loos, Director, on 9651 2699 or jason.loos@dtf.vic.gov.au.

Yours sincerely

Grant Hehir
Secretary

cc: Jason Loos, Director, *Partnerships Victoria*, DTF

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Auditor-General's reports

Reports tabled during 2011–12

Report title	Date tabled
Biotechnology in Victoria: the Public Sector's Investment (2011–12:1)	August 2011
Developing Cycling as a Safe and Appealing Mode of Transport (2011–12:2)	August 2011
Road Safety Camera Program (2011–12:3)	August 2011
Business Planning for Major Capital Works and Recurrent Services in Local Government (2011–12:4)	September 2011
Individualised Funding for Disability Services (2011–12:5)	September 2011
Supporting Changes in Farming Practices: Sustainable Irrigation (2011–12:6)	October 2011
Maternity Services: Capacity (2011–12:7)	October 2011
Procurement Practices in the Health Sector (2011–12:8)	October 2011
TAFE Governance (2011–12:9)	October 2011
Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2010–11 (2011–12:10)	November 2011
Public Hospitals: Results of the 2010–11 Audits (2011–12:11)	November 2011
Water Entities: Results of the 2010–11 Audits (2011–12:12)	November 2011
Portfolio Departments and Associated Entities: Results of the 2010–11 Audits (2011–12:13)	November 2011
Local Government: Results of the 2010–11 Audits (2011–12:14)	November 2011
Victorian Institute of Teaching (2011–12:15)	December 2011
Managing Contaminated Sites (2011–12:16)	December 2011
Compliance with Building Permits (2011–12:17)	December 2011
Management of Road Bridges (2011–12:18)	December 2011
State Trustees Limited: Management of represented persons (2011–12:19)	February 2012
Public Transport Performance (2011–12:20)	February 2012
Government Advertising and Communications (2011–12:21)	February 2012
Agricultural Food Safety (2011–12:22)	March 2012

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