9 December 2015 ▌ *East West Link Project*

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East West Link Project

Tabled 9 December 2015

The Auditor-General provides assurance to Parliament on the accountability and performance of the Victorian Public Sector. The Auditor-General conducts financial audits and performance audits, and reports on the results of these audits to Parliament.

On 9 December 2015, the Acting Auditor-General tabled his performance audit report, *East West Link Project.*

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Overview

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- The East West Link project was terminated in June 2015 with more than $1.1 billion paid, or expected to be paid, by the state for little tangible benefit.
- Cost will be partially offset by proceeds from the sale of properties acquired for the project, which the Department of Treasury & Finance (DTF) estimates are worth $320 million.
- The audit found:
  - flawed advice to government
  - signing the contract exposed the state to additional financial risk
  - final termination cost lower than under the contract, but only limited verification of reimbursed costs.

The East West Link project was to be one of the largest, most complex and costly transport infrastructure projects ever undertaken in Australia. It was terminated in June 2015 with more than $1.1 billion paid, or expected to be paid, by the state for little tangible benefit. This cost will be partially offset by the proceeds from the sale of properties acquired for the project, which the Department of Treasury & Finance, or DTF, estimates are worth $320 million.

The audit found flawed advice to government on the project and that signing the contract when there was a legal challenge to the project planning approval decision, exposed the state to additional risk.

The final termination cost was lower than the cost of terminating under the project contract. However, the decision to terminate was made without full consideration of the merits of completing the project, and the validity of costs reimbursed by the state were not fully verified.

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Background

- The expected cost of the entire East West Link project was $22.8 billion.
- Stage 1 (eastern section) approved in April 2013.
- A public private partnership contract was signed with East West Connect (EWC) on 29 September 2014.
- Following the November 2014 election, the incoming government suspended work on the project.
- Agreement reached with EWC in June 2015 to terminate the project.

If it had proceeded the entire East West Link project would have cost more than $22.8 billion in nominal terms.

The government decided to go ahead with the eastern section as Stage 1 of the project in 2013, and finalised a public private partnership contract with East West Connect, or EWC, in late September 2014, to finance, design, construct, operate and maintain the road.

The contract was signed before the November 2014 state election. Following the election, the new government instructed EWC to suspend work and reached agreement to terminate the project in June 2015.

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Background

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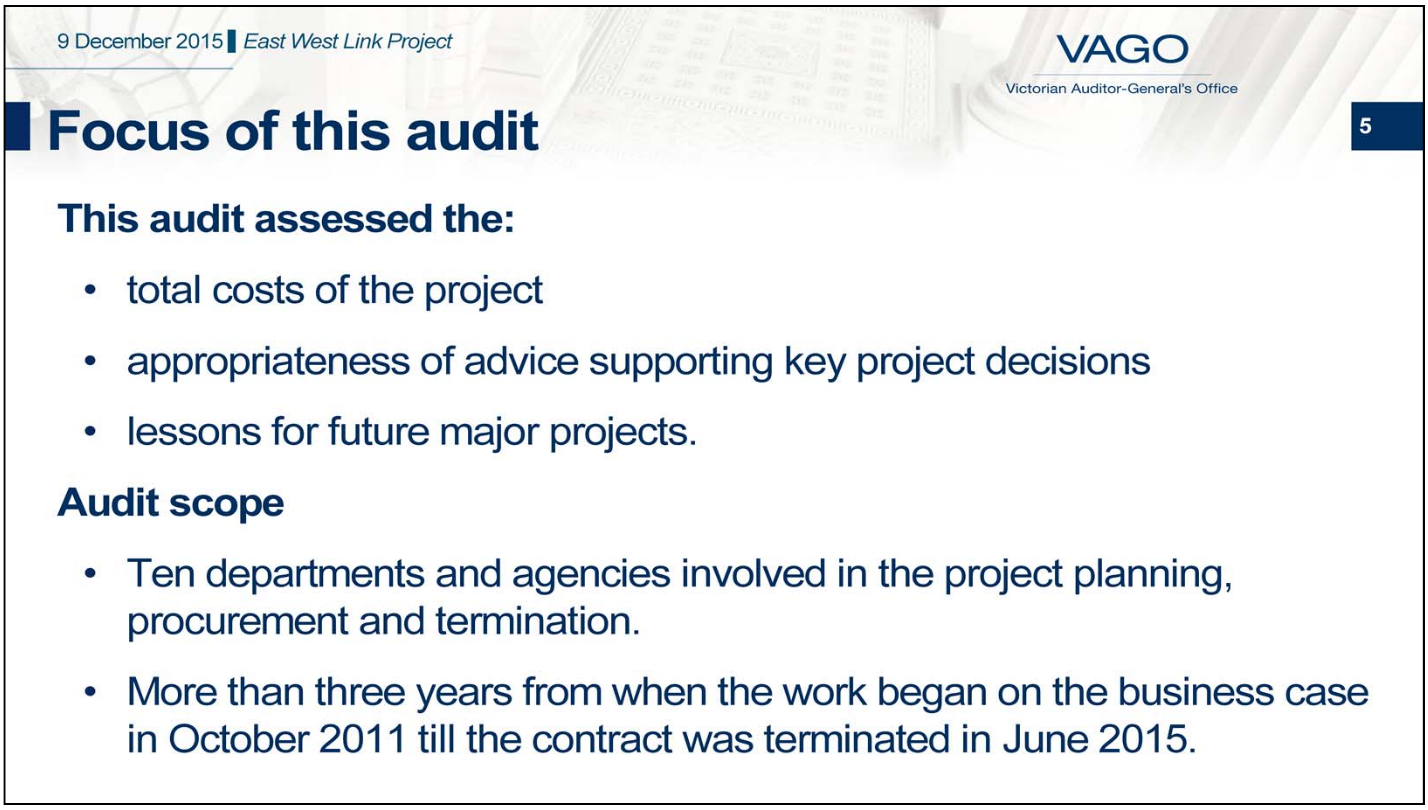
Planned East West Link

Source: 2014–15 Budget Information Paper.

The full project included an 18 kilometre cross city road connecting the Eastern Freeway at Hoddle Street, to CityLink, the Port of Melbourne precinct, and the Western Ring Road at Sunshine West.

The main component of the eastern section (Stage 1) was a new tolled motorway linking Hoddle Street and CityLink (mainly via tunnel).



The audit examined whether the state effectively managed the East West Link project by assessing the:

- total costs of the project
- appropriateness of advice supporting key project decisions, and
- lessons for future major projects.

The audit covered 10 departments and agencies involved in the project planning, procurement and termination over more than three years from October 2011 to June 2015.

Project Costs

pages 9–17

- $1.1 billion to be paid by the state for little tangible benefit.
- Cost will be partially offset by proceeds from the sale of properties acquired for the project, which DTF estimates are worth $320 million.
- Main costs were for property acquisitions ($350 million) and termination ($642 million).
- Cost tracking for the eastern section was mostly robust, but no whole-of-project monitoring and reporting on costs.

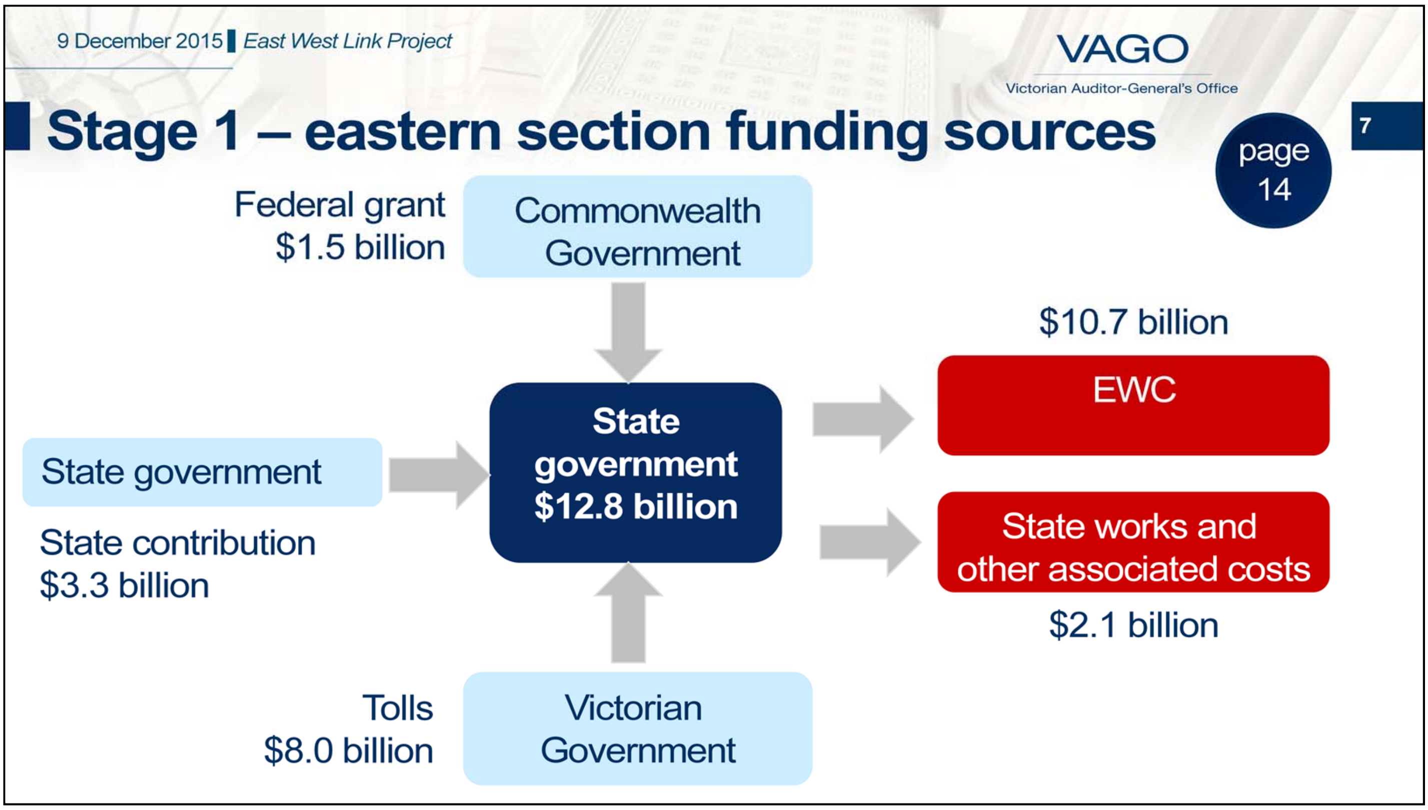
DTF should provide guidance to support whole-of-project cost tracking for major projects across stages and agencies.

The project was terminated in June 2015 with more than $1.1 billion paid, or expected to be paid by the state. This covered the planning, development, procurement and termination of the project, and will be partially offset by future sale proceeds from properties acquired for the project. DTF estimates that these properties can be resold for $320 million.

The main areas of expenditure were for property acquisitions and termination. The termination settlement costs of around $642 million comprise $424 million paid to EWC, as reimbursement for project costs incurred and around $218 million on settling an arrangement taken over by the state, as part of the termination relating to the financing risks on the project.

Arrangements for tracking costs on the eastern section were mostly comprehensive and robust. However, although only minimal costs were incurred on the western section, there was no whole-of-project monitoring and reporting on costs.

DTF should provide guidance to support whole-of-project cost tracking for major projects across stages & agencies.



This figure shows the funding sources and flows for Stage 1—eastern section. The majority of the costs over the full lifespan of the Eastern Section were to be met by tolls on users of the road.

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Planning the project – business case

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pages 19–30

- Business case did not provide a sound basis to prioritise the eastern section.
- Investment merit relied heavily on wider economic benefits.
- Wider economic benefits and traffic modelling not adequately supported by evidence.
- Issues raised by peer reviewers not addressed.

DTF should improve its business case development guidance and quality assurance over key inputs.

The business case is a critical step in any major project but in this case it:

- did not provide a sound basis for prioritising the eastern section over other sections of the road.
- relied heavily on the inclusion of wider economic benefits to demonstrate the merit of the proposed investment
- did not include sufficient information and evidence to demonstrate the accuracy and plausibility of the assumed wider economic benefits and traffic modelling, and
- did not adequately address significant issues raised by peer reviewers in relation to both the traffic modelling and wider economic benefits.

DTF should improve its business case development guidance and quality assurance over key inputs.

The procurement process was robust and met the government's target time line.

Advice to government in the lead up to contract signing did not sufficiently emphasise the benefits of delaying contract signing to mitigate risks, posed by an unresolved legal challenge to the project planning approval decision. Signing the contract in these circumstances exposed the state to greater cost and risk.

DTF should develop minimum standards and enhanced guidance to manage concurrent planning, scoping and procurement risks.

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Terminating the project

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pages 45–54

- Advice to government on the merits of termination did not adequately examine the completion option.
- Although final agreements differed to initial government announcements, these delivered a better outcome.
- The total cost of termination settlement will be around $642 million.
- VAGO could not address due diligence limitations due to gaps in the *Audit Act 1994*.

DTF should establish guidance for terms of negotiations to require full transparency before private reimbursement.

The advice to the new government on the merits of terminating the project did not adequately examine the costs, risks or benefits of completing it.

The final termination agreements involved a different settlement outcome, to that initially announced by the government based, on sound advice and delivered a better outcome for the state.

The total cost of the termination settlement will be around $642 million depending on the final cost of settling an arrangement taken over by the state, relating to the financing risks on the project. This is less than what would have been payable under the contract.

The state accepted EWC's refusal to allow access to the records of its related party contractors. This meant that the validity of project costs, reimbursed by the state, could not be fully verified and created a risk that these related parties had a windfall gain. Weaknesses in the *Audit Act 1994* mean that VAGO could not obtain the information required to confirm this.

DTF should establish guidance for terms of negotiations to require full transparency before private reimbursement.

Advice to government over the life of the project did not always meet the frank and fearless standard. This highlights a risk to the integrity of public administration that needs to be addressed.

The audit identified instances where advice did not provide clear recommendations or gave too much emphasis to the benefits of approaches in line with government's known preferred outcome and little emphasis to the analysis and benefits of alternative approaches.

The Department of Premier & Cabinet (DPC) and DTF disputed this finding, relying on a narrow interpretation of the Public Administration Act and the *Code of Conduct for Victorian Public Sector Employees.* However, the Act seeks a public service which responds to government policy priorities, in a manner consistent with public sector values. This means, there is sometimes a need to provide advice that a government may not necessarily want to receive.

DPC needs to support further guidance to clarify the requirements for frank and fearless public sector advice.

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Recommendations

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		Accept
That DTF:		
1.	provides guidance to support whole-of-project cost tracking and reporting against budgets for major projects that involve multiple stages managed by different agencies	×
2.	improves its business case development guidance material, the adherence to this guidance by agencies, and its quality assurance over key inputs by: • critically reviewing the analysis of options in business cases • developing further guidance determining wider economic benefits • strengthening processes for advising government on the adequacy of actions to address recommendations from peer or other external reviews.	×

The following three slides show a series of recommendations that focus on the key areas requiring improvement.

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Recommendations – *continued*

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		Accept
That DTF:		
3.	develops minimum standards and enhanced guidance for managing the risks associated with concurrent planning, scoping and procurement processes on major projects	×
4.	mandates the appointment of separate parties to undertake the probity advice and probity compliance review functions on High Value High Risk projects	×
5.	establishes clear guidance for the terms of future negotiations involving the state reimbursing expenditure by private entities, to require full disclosure and transparency of the underlying information and evidence.	×

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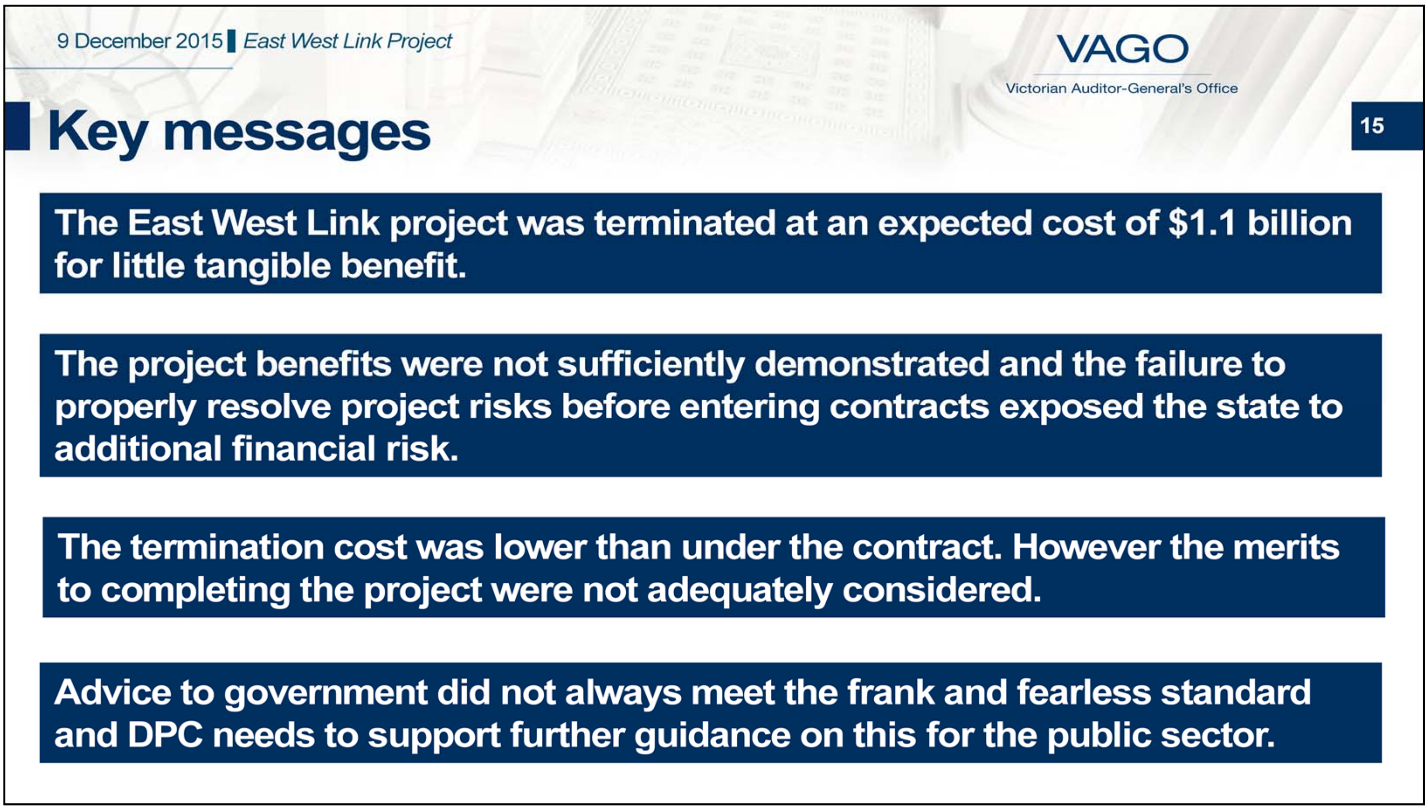
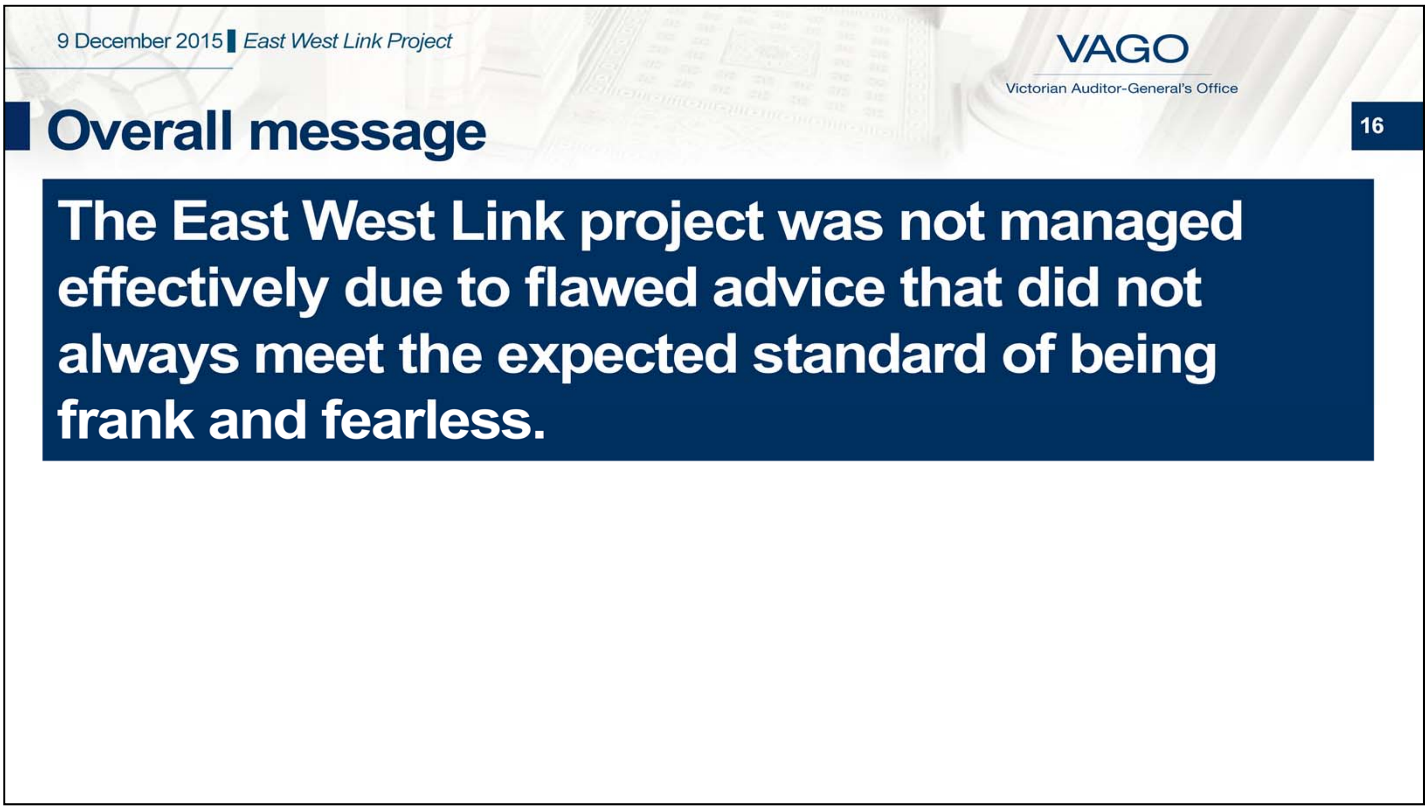
Recommendations – *continued*

		Accept
That the DPC consults with the Victorian Public Sector Commission to:		
6.	support further guidance emphasising requirements for frank and fearless advice in the public sector by: • establishing clear minimum standards for agencies on how to satisfactorily discharge their statutory obligations when providing advice to government • advising government on strategies and options for addressing any cultural issues underpinning the serious deficiencies in the advice provided to government highlighted by this report.	×

DPC and DTF have not accepted the recommendations.



The key messages arising from this audit are shown on this slide.



The overall message is that the East West Link project was not managed effectively, due in part to flawed advice that did not always meet the expected standard of being frank and fearless.

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Relevant audits

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- *Management of Major Road Projects (2010–11)*
- *Impact of Increased Scrutiny of High Value High Risk Projects (2013–14)*
- *Applying the High Value High Risk Process to Unsolicited Proposals (2015–16)*

Relevant audits are listed on this slide.

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Contact us

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