



VICTORIA

Report of the Auditor-General

COMPREHENSIVE AUDITS

Government Stores Operations
Departmental Cash Management

October 1984

PROPERTY OF

Russell Walker

VICTORIA

Report

of the

Auditor - General

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Departmental Cash Management

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Office of the Auditor-General
MELBOURNE, Victoria, 3002

October 1984.

Sir,

Pursuant to the provisions of Section 48 of the Audit Act 1958, I transmit a report relating to stores and cash management. The report also sets out the approach I have adopted in implementing comprehensive auditing.

Yours faithfully,

B.J. WALDRON
Auditor-General

The Honourable the Speaker,
Legislative Assembly,
Parliament House,
MELBOURNE, Vic. 3000.

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PREFACE

Last year I presented a final report to the Parliament on a review of procedures of government departments and authorities with respect to works contracts.

The response to comments and the action taken on identified opportunities for improvement, referred to in such reports, are of course a matter for the organisations under review. In this connection I note the initiatives taken since tabling the works contracts final report. These include:

- action taken by the Department of Management and Budget to develop an integral system of works planning, programming and budgeting and to review project management and procedures; and
- the recommendation by the Building Industry Investigation Committee for the establishment of a unit to co-ordinate and monitor standards of management, documentation and administration on government works.

This report covers 2 further reviews undertaken by my Office, and deals with a review of procedures adopted in the areas of stores by government departments and authorities and cash management by government departments.

I am encouraged by the response, at all levels, of those whose activities have been reviewed. It will be clear from the replies by management in these reports that, where they have the resources and capacity to make changes, there has been a quick and ready response to improve procedures and arrangements and, in a number of instances, during the course of the audit review.

Finally, I draw attention to Part 1 of this report. The move to comprehensive auditing follows recognition that managers in the public sector are accountable for the economical, efficient and effective use of resources under their control. In Part 1 I set out the approach I have adopted in implementing comprehensive auditing and its relationship with the activities of government review organisations.

1. Approach to Comprehensive Auditing

INTRODUCTION

1.1 In recent years, my reports to Parliament have included comments on the gradual extension of the scope of audit activity within my Office to encompass value for money issues. My comments have centred on the progressive implementation within the Office of the audit methodology known as comprehensive auditing.

1.2 Comprehensive auditing is a concept developed originally in Canada which has its primary application in the public sector. In an external audit context it extends the audit role beyond the expression of opinion on financial statements and questions of regularity or compliance with legislative and policy directives. It embraces the additional component of provision of an independent and objective assessment of the monitoring processes used within organisations to ensure that resources are economically and efficiently utilised and objectives of programs are achieved.

1.3 During the last 2 years, a number of pilot studies in comprehensive auditing have been conducted by the Office. In addition, a major review of practices employed by government bodies with respect to works contracts was undertaken. Two reports on this major audit review were tabled in Parliament - the first in June 1982 and the second and final report in June 1983. In 1983-84, several additional comprehensive audit projects were completed by the Office. Two of these projects are the subject of separate comments in later sections of this report.

1.4 Field experience acquired to date by my officers on specific comprehensive auditing assignments has enabled adaptation of the Canadian model to suit the local audit environment. In this regard, I have now formulated a policy governing the role of the Auditor-General in comprehensive auditing and the characteristics of the manner in which this widened audit methodology is undertaken within my Office.

1.5 The rationale underlying the development of an Office policy on comprehensive auditing is the need to provide Parliament with the highest quality of audited information to assist in its oversight of the financial operations of the State and to complement recent financial reforms by the Government, particularly program budgeting. The requirement under program budgeting that departments develop means of monitoring the efficiency and effectiveness of their operations articulates closely with the comprehensive auditing approach.

1.6 The legislative authority for the implementation of this policy is derived from Section 48 of the Audit Act 1958. This Section enables the Auditor-General to recommend methods for the better collection and payment of public moneys and for more effective and economical auditing.

1.7 In my Second Report for 1982-83, I expressed support for the Economic and Budget Review Committee's recommendation, contained in its Report on a Review of the Audit Act 1958 tabled in the Legislative Assembly on 1 June 1983, that specific statutory provision be made in revised audit legislation for the Auditor-General to undertake efficiency and effectiveness audits. To date, no action has eventuated on this recommendation.

COMPONENTS OF COMPREHENSIVE AUDITS

1.8 A comprehensive audit may be described as an examination of the controls, processes and systems used to manage the financial, human and physical resources of an organisation.

1.9 Comprehensive audits as adopted by my Office include both a financial and regularity audit component and a value for money audit component.

1.10 The financial and regularity audit component is the base upon which value for money auditing activities in the Office are being built.

1.11 The objective of the financial and regularity audit component is to determine whether:

- (1) financial statements present fairly the financial transactions and, where appropriate, financial position of the audited entity and are in accordance with legislative requirements and Australian Accounting Standards; and
- (2) financial operations have been conducted with propriety and in accordance with legislative requirements.

1.12 The value for money component includes efficiency and effectiveness audit elements and, in some circumstances, a review of the economy of operations (or particular aspects of operations).

1.13 The objective of the value for money audit component is to evaluate:

- (1) the processes by which management translates objectives established by legislative or ministerial directive into operational objectives; and
- (2) the adequacy of mechanisms set in place by management to monitor the efficiency with which resources are used and the effectiveness with which operational objectives are achieved.

1.14 The emphasis in the value for money audit component is directed to 3 areas of examination, namely:

- (1) Monitoring the efficiency of operations which includes:
 - . identifying the systems management has in place to monitor and promote efficiency within the organisation; and

- . evaluating whether management is provided with regular, timely and relevant reports which include information on the manner in which resources absorbed in operations (inputs) are related to goods or services produced (outputs).

(2) Monitoring the effectiveness of operations which involves:

- . identifying major operational objectives of the organisation, program or division;
- . ensuring that these objectives are consistent with legislative or ministerial directives, are measurable and have been quantified;
- . ensuring that operational objectives have been set for all levels of the organisation and that they are consistent with higher-level objectives; and
- . assessing the adequacy of mechanisms set in place to monitor the achievement of operational objectives.

(3) Identifying the decision-making processes and procedures followed by management and determining:

- . whether these processes and procedures consider value for money questions and are periodically reviewed to ensure their continued adequacy and relevance; and
- . the extent to which decisions are based on the use of all such value for money information and whether the immediate and long-term results of those decisions are monitored.

1.15 As far as practicable, integrated planning processes for financial and regularity and value for money audit components will be progressively adopted in the Office.

1.16 It is expected that comprehensive audit projects will account for approximately 50 per cent of total audit time by 1986-87.

TIMING OF COMPREHENSIVE AUDITS

1.17 Comprehensive audits will not be conducted in each organisation on an annual basis. Annual financial audits will be conducted where required by legislation and, when adequate performance measures have been developed, audit may be required to express an opinion on the accuracy of efficiency and effectiveness measures contained in annual reports. With these exceptions, a comprehensive audit cycle of 3-5 years will be established unless shortcomings in the auditee indicate that more frequent follow-up audits are necessary.

1.18 Apart from comprehensive audits on individual organisations, across-the-board audits, either comprehensive or confined to value for money issues, of similar functional areas, procedures or systems in different organisations may be conducted.

RELATIONSHIP WITH CENTRAL AGENCIES

1.19 It is important to understand the relationship between the role of the Auditor-General in comprehensive audits and functions undertaken within government by the 3 central agencies, namely, the Department of the Premier and Cabinet, the Public Service Board and the Department of Management and Budget.

1.20 The operations of the 3 central agencies are directed to meeting the needs of the Executive on a range of advisory, consultancy, monitoring, co-ordinating and review activities concerning policy and financial and organisational management.

1.21 The central agencies may be described as a major element of the framework by which accountability relationships concerning resource management are established between the central government and the individual organisational units of government. Their existence reflects the important principle that it is the responsibility of government to ensure that sound arrangements are in place for the efficient and effective use of resources within its control.

1.22 Each of the central agencies has responsibility for provision of policy advice to government on specific facets of resource management. In addition, the central agencies are involved in on-going consultative relationships with organisational units, with emphasis on efficient and effective management of resources in accordance with prevailing policies and priorities of government.

1.23 Reviews by the central agencies of financial or organisational processes within government tend to have a number of common characteristics. Some of these characteristics are listed below:

- (1) Reviews are often solution-oriented, i.e. the assignment may be undertaken to prescribe and implement corrective measures by specific direction of the government or may be geared towards a problem as identified or perceived by organisational management.
- (2) Review teams can play an active role in the development of organisational or operational objectives and the establishment of criteria such as standard performance measures.
- (3) Review personnel may be involved, in conjunction with line management, in the implementation of recommendations arising from reviews.
- (4) Reports are structured primarily to meet the internal needs of government and, in many cases, are not intended to be available for external publication.

1.24 These characteristics contrast with the characteristics of external audit, under which the auditor must be independent of the systems being evaluated and is not involved in the implementation process, so as to maintain an objective viewpoint (as discussed further in para. 1.29) and reports to an external party.

1.25 In summary, there are clear linkages between the functions of central agencies and the internal accountability relationships of government.

1.26 In contrast to the functions of the central agencies, the aim of comprehensive audits undertaken within my Office is to enhance the usefulness of the role of the Auditor-General in the accountability of the Executive to Parliament. In this regard, emphasis is placed on the need for Parliament to receive independent and audited information on matters relating to the efficiency and direction of use of resources by government organisations. This information is generated from an external audit process divorced from the internal accountability relationships of the Executive.

1.27 The Auditor-General has no statutory power to enforce improvements to financial management and procedures. The power is one of scrutiny and reporting to Parliament.

1.28 It is most important to emphasise that the thrust of a comprehensive audit conducted by my Office is on an independent and objective assessment of mechanisms set in place by auditees for monitoring the efficiency and effectiveness of their operations.

1.29 The report issued at the completion of each comprehensive audit does not include any expression of opinion on whether or not an organisation is effective or efficient. Although it contains constructive comments on weaknesses disclosed, it does not provide solutions to inefficient or ineffective systems or procedures and the auditor does not participate in the implementation of changes recommended by audit. The independence and objectivity of the comprehensive audit process could not be preserved if the auditor became involved in such activities. In this respect the role of audit sharply contrasts with management advisory or consultancy functions.

1.30 The selection and timing of value for money audit projects and decisions on the level and direction of audit resources are solely the province of the Auditor-General.

1.31 Reports of comprehensive audits are presented to Parliament and to the management of the audited entity.

1.32 In identifying areas with potential for comprehensive audit review, cognisance is given, inter alia, to any internal reviews carried out by the central agencies. This approach is analogous to evaluation of internal control systems in financial and regularity audits.

RELATIONSHIP WITH INTERNAL AUDIT

1.33 In many organisations, internal audit will be concerned not only with financial and regularity aspects but with other audit objectives such as the efficiency or effectiveness of activities under review, although the extent of this may vary between organisations. The interim standards for internal audit issued by the Department of Management and Budget in January 1984 provide for a broad scope function for internal audit units within the Victorian Public Service.

1.34 The development of an adequate internal audit function has important implications for external audit. If a high degree of reliance can be placed on internal audit work and if internal audit has recently audited potentially significant areas identified by external audit, then external audit testing of those areas may be reduced. This general principle applies equally to value for money and financial audit components.

STAFFING

1.35 Although most of the skills required for comprehensive auditing are accounting based or are adequately provided by a good accounting qualification, skills of other disciplines may be required from time to time in certain comprehensive projects. Where necessary, professional expertise in non-accounting areas is obtained by secondments or the use of consultants. This specialist assistance is particularly relevant in large-scale studies involving substantial technical considerations.

1.36 Many of the audit techniques and skills required for systems based financial audits are well suited to comprehensive auditing. As such, it is intended to progressively adopt an integrated planning approach within the Office for both financial and value for money audit activities. This integrated approach will be aimed at ensuring the most efficient allocation of available resources to audit projects and enabling staff to acquire and develop specific skills relevant to comprehensive auditing.

1.37 Accompanying moves towards an integrated auditing framework within the Office is an increasing use by audit staff of EDP based audit tools with substantial potential for increased audit efficiency. Consequently, the development of comprehensive auditing within the Office is not expected to lead to substantial demands for additional funds or increased staffing levels.

2. Review of Government Stores Operations

INTRODUCTION

2.1 An audit review group was established in November 1983 to conduct a major review of stores procedures in the public sector using comprehensive audit methodology. This type of operation was selected for review due to the magnitude of funds invested and the associated costs of operating stores.

2.2 This is the second across the board study using comprehensive audit methodology conducted by this Office. The first study, a review of Works Contracts procedures was reported to Parliament in my report of 30 June 1982 and 15 June 1983.

2.3 Under the comprehensive audit approach, the Office is concerned with evaluating the processes by which organisations translate broad objectives into operational objectives, and the adequacy of the systems used to monitor effectiveness and to achieve and monitor efficiency. It should be stressed that the concern is not with evaluating objectives given to organisations by legislation or by ministerial directive.

2.4 At 30 June 1983 stores in excess of \$181 million were held in store throughout the State. Annual turnover or issues of those stores amounted to \$565 million. Attached to Part 2 is a schedule giving details of those stores on hand, together with turnover, which is summarised as follows:

	<u>Value of Stores on Hand 30 June 1983</u> (\$ M)	<u>Turnover 1982-83</u> (\$ M)
Government Departments	20	48
Statutory Authorities	161	517
	<hr/>	<hr/>
	181	565
	<hr/>	<hr/>

2.5 Stores as defined in Section 3 of the Audit Act 1958 are "any moveable property of or belonging to or in the care, custody or control of the State or of any public authority". Government departments and statutory authorities hold a wide range of items to service their particular needs, including stock-in-trade, spare parts, appliances and office supplies. This review did not cover items of a capital nature, such as plant and equipment.

2.6 For departments and ministries, storekeeping procedures are governed by the Department of Management and Budget Regulations 1981, which contain provisions for the receipt and custody of stores, stocktaking requirements, and disposal of obsolete or unserviceable stores.

OBJECTIVES OF THE REVIEW

2.7 With the expenditure of such large sums of public funds on the purchase of stores it is essential that timely information is available for correct stocking decisions and that there is an efficient use of resources in providing a timely service to users of stores. The main responsibility of a stores branch is to provide the organisation it serves with goods required from outside the organisation in the right quality, in the right quantity, at the right price and at the right time, as well as to operate efficiently itself so as to minimise costs to users and the organisation as a whole.

2.8 The basic objective of the review was therefore to determine whether stores operations are being managed in accordance with these criteria, to ensure that there is proper accountability of public funds, and that they are spent in an economic, effective and efficient manner.

2.9 Purchasing issues have been included in the review only to the extent of assessing the adequacy of procedures for determining required amounts of purchases. Issues of purchasing policy such as contracting, tendering, bulk purchasing and State preference arrangements have not been considered. These latter aspects are being reviewed by the Government Purchasing Policy Review Team and it was decided not to duplicate the work of this team. Thus, the review did not seek to evaluate the full extent to which the stores branches satisfied the needs of users in terms of quality and appropriateness of goods purchased or promptness of supply. However, evaluating the efficiency of stores operations, which affects the overall costs of goods supplied to users, was a major focus of the review.

2.10 The terms of reference established to conduct the review were as follows:

To ascertain whether the following desirable features are present in public sector stores systems and direct purchasing arrangements:

- (1) procedures for determining the optimum or desired levels of inventory, including proper estimation of forward requirements and adequate monitoring of the cost and efficiency of the stores function;
- (2) procedures for the regular review of needs and existing levels of inventory;
- (3) adequate recording of receipts, inventory on hand and issues of stores;
- (4) adequate authorisation procedures for the purchasing and issuing of inventory, including procedures for the charging of inventory issued against responsibility centres and other procedures to ensure economical use of inventory;
- (5) adequate physical security of inventory, both within and outside stores; and

(6) adequate regulations to achieve these objectives.

2.11 These terms of reference were supplied to the heads of all organisations prior to the commencement of the review.

SCOPE OF THE REVIEW

2.12 A survey of stores held by government departments and statutory authorities was conducted as the first step in the review. Based on the results of this survey and bearing in mind the need to obtain an adequate representation of public sector bodies, it was decided to review in detail the stores operations of departments having inventory holdings in excess of \$1 million each. Also taken into consideration were the function of departments/authorities selected, the service provided, the expected activity levels, and the nature of items being held. As a result, 2 government departments, 2 branches of government departments and 3 statutory authorities were selected for review. These were:

State Electricity Commission (SEC)
Gas and Fuel Corporation (GFC)
State Transport Authority (STA)
Education Department (Education)
Victorian Government Printing Office (VGPO) - part of
Department of Property and Services
Public Works Department (PWD)
Office of the Chief Commissioner of Police (Police) - part
of Ministry of Police and Emergency Services

2.13 In view of the representative nature of the 7 organisations selected, in my opinion the detailed comments in the report can be regarded as generally applicable to all stores operations in the Victorian public sector.

CONDUCT OF THE REVIEW

2.14 Following selection of the organisations a plan was developed to gain an overview of the structure of the stores branch of each, the nature of its operations and the factors which influence its efficiency and effectiveness of operation. Interviews were conducted with senior officers responsible for stores operations as well as key personnel directly involved in functions relating to recording, control and physical handling. Physical inspection of stores facilities was undertaken, together with an analysis of systems and an examination of available documentation to establish the adequacy of information systems for the effective management of operations.

2.15 Due to time constraints and the wide-spread nature of certain operations, e.g. State Electricity Commission, it was not practical to visit all stores locations of each of the organisations. Visits were made to a representative sample of storehouses, with selection criteria being based on inventory levels, location, volume of transactions, type of inventory, and nature of the store.

2.16 Detailed draft audit reports were made available to the organisations concerned prior to the release of this report. Relevant comments from these organisations on audit observations are included in this report.

2.17 The study has been managed by an audit review group consisting of officers from my staff and a senior internal auditor from the Broken Hill Proprietary Company Ltd. with extensive experience in stores management. I wish to record my appreciation to the corporation for making his services available and providing a valuable private sector perspective in the review. In addition, I wish to express my thanks to the group for their dedicated and professional approach. The full co-operation and assistance received by the group from officials of the relevant government departments and authorities is also acknowledged.

GENERAL SUMMARY OF FINDINGS

2.18 The Review identified a need for a significant upgrading in stores management procedures in the Victorian public sector. In general, organisations have failed to pay sufficient attention to monitoring and reviewing their stores operations and have not applied modern resource management techniques.

2.19 Significant levels of over-stocking were identified in 6 of the 7 organisations examined. These excessive stocks are a significant value for money issue. Apart from the capital tied up in the stocks themselves, there are associated costs in terms of storage space and stores operations. The over-stocking is symptomatic of the major deficiencies in stores management procedures discussed in the following sections.

2.20 More detailed comments are contained in the report under SEC (para. 2.28), GFC (para. 2.40), STA (para. 2.51), Education (para. 2.58), VGPO (para. 2.72) and Police (para. 2.86).

2.21 As indicated above, the objective of the review as set out in the terms of reference was not specifically to identify or quantify over-stocking by government organisations. Rather, the objective was to examine the adequacy of stores operations to ascertain whether systems were in place which would prevent over-stocking and generally result in an efficient and effective stores operation. The reasons for the over-stocking differ somewhat between the organisations reviewed, although there are certain major common contributing factors, which are now discussed under each part of the terms of reference for the review.

A. Procedures for determining the optimum or desired levels of inventory, including proper estimation of forward requirements and adequate monitoring of the cost and efficiency of the stores function.

It is important that organisations establish ordering procedures which are based on proper forecasting of requirements and which take into account economic order quantities and the costs of holding stock, and that such procedures be regularly reviewed.

Audit identified many cases in the organisations surveyed where ordering procedures were unsatisfactory.

For example, audit identified premature purchase of material because of the lack of incentive for users to purchase on a timely basis (SEC, para. 2.32), of insufficient analysis in formulating purchasing requirements (VGPO, para. 2.72.2 (2)) and of re-ordering criteria which do not take into account the costs of ordering and holding stocks (Education, para. 2.63).

Other comments on ordering procedures are made in SEC (para. 2.29), GFC (paras. 2.41 and 2.42), STA (paras. 2.52.3 (1) and (2)), VGPO (para. 2.70.3), PWD (para. 2.81.1), and Police (paras. 2.89 and 2.87.2 (3)).

The review findings indicated a general need for the organisations to give greater consideration to the total cost involved in running a stores function when making decisions on purchasing and inventory holding.

It is important that the costs and efficiency of stores operations be adequately monitored by a set of performance measures. Each stores organisation should have performance evaluation measures, with established benchmarks, produced on a regular and timely basis and reviewed by a responsible officer. Such measures should include:

- (1) turnover rate of individual items;
- (2) cost of operations relative to:
 - (i) value of holdings;
 - (ii) value of issues;
- (3) value of items that have not moved for 12 months relative to total stock value;
- (4) number of "out-of-stock" situations; and
- (5) transactions per stores employee.

The review identified the lack of performance measures as a major problem.

In the organisations reviewed, only the SEC had adequate performance measures in operation. Comments on other organisations are made under GFC (para. 2.42), Education (para. 2.61), VGPO (para. 2.75), PWD (para. 2.81.3) and Police (para. 2.90).

The development of performance measures is a matter requiring urgent attention in government stores organisations.

<p>B. Procedures for the regular review of needs and existing levels of inventory.</p>
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The review has highlighted a general lack of management reports within the stores information systems which identify slow moving stocks.

Fundamental to proper stores management is the provision of regular reports to management on slow moving stocks. In a number of cases it was found that the only regular reports on stock movements were reports on stock which had not moved at all for a considerable period of time. This is clearly not an adequate means of identifying slow moving items i.e. one unit of a stock item could have moved within the period yet overall the stock item might be moving very slowly.

More detailed comments are made under SEC (paras. 2.28, 2.30, 2.31 and 2.32), GFC (para 2.40), STA (2.52.3 (3)), Education (para. 2.59.2), VGPO (para. 2.72), PWD (para. 2.81.1), and Police (para. 2.87.2 (1)).

The review also identified a general problem with stocktaking procedures which in many cases are not cost effective.

In some cases, stocktakings are carried out with insufficient regard to the materiality of the items being reviewed, to the risk of their loss and to the cost of the stocktake. In audit opinion, the degree of control achieved by stocktakes would be improved if programmed interim stock counts were adopted with criteria such as the item value, turnover, nature of stock, and adequacy of security being taken into account in determining the extent of physical checking.

Specific comments are made under SEC (para. 2.33), GFC (para. 2.43), Education (para. 2.62), VGPO (para. 2.74) and PWD (para. 2.83).

C. Recording of receipts, inventory on hand and issue of stores.
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The review identified a number of cases of inadequate stores information systems.

Audit recognises that in most cases action is currently being taken to upgrade these systems. In some cases the stores information system does not provide the type of information required for proper management and control of stores, such as reports on slow moving items. In other cases, the stores system itself does not provide information which is accurate and reliable, which could result in incorrect decisions being made. (VGPO, para. 2.71).

Audit estimated that inadequacies in one computer system, in particular the significant delays which occurred in the processing of information, have caused an over-investment in stocks of between \$1.35m and \$2.5m. (SEC, para. 2.28).

Audit also identified duplication of stores recording resulting in unnecessary labour and other costs (STA, para. 2.53). One existing stores accounting system involves a significant amount of manual work and as such is a high cost operation (PWD, para. 2.81.1). Further detailed comments on this issue are made under (VGPO, para. 2.71.2).

Adequate systems are operating in only one organisation, the Gas and Fuel Corporation.

Audit noted that organisations developing new stores computer systems all proceeded independently of each other, acquiring different hardware and software. Audit considers there would have been scope for some joint development of systems and sharing of expertise.

D. Authorisation procedures for the purchasing and issuing of inventory, including procedures for the charging of inventory issued against responsibility centres and other procedures to ensure economical use of inventory.

A general problem is the significant control over inventory holdings being exercised by users who are not held accountable for the cost of ordering or holding decisions.

In some cases, users must give their approval before obsolete items can be scrapped. In all such cases there is a need for the organisation to consider ways in which users might be held accountable for such costs to avoid excess inventory holdings.

One organisation must bear the cost of holding surplus stocks of publications despite decisions on production levels being made largely by user departments (VGPO, para. 2.72.2 (2)). The same problem applies to the relationship between stores and operating divisions within other organisations. Additional comments are made under SEC (para. 2.32) and STA (paras. 2.52.3 (3) and 2.54).

A further problem identified was that of uneconomic use of inventory in relation to the Education Department store.

Audit established that school councils purchased significant quantities of stock items from independent suppliers at considerable additional cost (Education, para. 2.58).

E. Adequate physical security of inventory both within and outside stores.

A number of store houses in the Port Melbourne Store Yard of the Public Works Department were in varying states of disrepair, thus causing security problems (PWD, para. 2.82).

F. Adequate regulations to achieve these objectives.

The 4 government departments reviewed are subject to the Department of Management and Budget Regulations 1981. Two significant considerations arise from these regulations:

- The requirements for the writing-off of stock discrepancies following stocktakes are complex and time consuming. A discrepancy report must be prepared by the officer-in-charge of stores and approval obtained from the Permanent Head before any adjustments to records can be made. Prompt adjustment of records may not be made because of the administrative costs of doing so. This may create problems in that, while stock records remain inaccurate, wrong inventory decisions could be made.

- The procedures for the disposal of obsolete or unserviceable stores also appear too restrictive and time consuming, with the requirement for Boards of Survey to be convened before stock can be disposed of. Because of the administrative costs involved, and the fact that disposal proceeds go to the Consolidated Fund, there seems to be little incentive for departments to take such action.

Those organisations, the operations of which are not financed from moneys forming part of the Public Account and which consequently are not subject to the Regulations enjoy a greater degree of flexibility in prescribing internal procedures for adjusting stock discrepancies and disposing of obsolete stocks.

Audit is of the opinion that economies of operation could be achieved by having uniform and consistent controls applied in the management of stores throughout the public sector and recommends that the Department of Management and Budget undertake a review of the existing regulations.

Specific comment on this issue is not included in the report as it is essentially a matter for the Department of Management and Budget to resolve. Departmental comment supported the audit viewpoint.

STATE ELECTRICITY COMMISSION

OVERVIEW OF STORES OPERATIONS, POLICIES AND PROCEDURES

2.22 The S.E.C. holds stores at several hundred locations throughout the State. These storehouses range from small stores holding less than \$20 000 to substantial operations having custody of up to \$20 million in stocks. Overall, these holdings comprise some 25 000 general purpose items, 2 500 merchandise appliances and 60 000 spares, covering a comprehensive range of electrical and mechanical components as well as general industrial and mining items. The stores issue about 1.5 million items per year with a value of approximately \$140 million.

2.23 Metropolitan stores operations are centralised at Brooklyn with ancillary stores being spread throughout the metropolitan area. In the Latrobe Valley major stores are located at Morwell and Yallourn with smaller stores being located at each of the power stations. In addition, there are 10 regional storehouses servicing smaller district locations. Substantial stocks of spare parts and transformers are also held at sub-stations and terminal stations.

2.24 At 30 November 1983, of a total stock holding of \$105.6 million, the value of holdings at each of the Commission's stores was as follows:

	General Purpose Items (\$M)	Spares and Appliances (\$M)	Totals (\$M)
Latrobe Valley stores	8.5	51.8	60.3
Metropolitan Central and Ancillary stores	20.0	6.2	26.2
Regional and District stores	14.0	-	14.0
Sub-station and Terminal station stores	-	5.1	5.1
	-----	-----	-----
Total	42.5	63.1	105.6
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2.25 At 30 November 1983, 760 persons were employed in stores operations and payroll costs were approximately \$18.1 million.

2.26 To assist in the monitoring and control of stores operations, the Commission has developed performance evaluation criteria in relation to monthly variations in stock values, purchases, issues, operational costs and turnover ratios. Specific objectives are established annually concerning staffing levels, personnel training, turnover rates, safety standards and standards of customer service.

SUMMARY OF MAJOR AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.27 The major observation arising from the review of the S.E.C. stores operations relates to excess stock holdings. A number of factors have contributed to excessive stock holdings, the major ones being:

- (1) Delays in computer processing of information have resulted in an over-investment in stock of between \$1.35 million and \$2.25 million.

Audit recommends that a new computer system, currently under development, be introduced as soon as possible in order to reduce delays in processing orders and to assist in the identification of slow moving stocks.

- (2) Established procedures for determining re-order points and re-order quantities are not operating as specified, resulting in an over-investment in general purpose stocks of \$7.44 million.

Audit recommends that re-ordering procedures be strictly complied with and a review be undertaken of general purpose stock holdings with a view to reducing stock levels.

AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.28 Computer System

Observations

- (1) The existing computer system is inadequate in that significant delays in the processing of orders have contributed to excessive stock levels of between \$1.35 million and \$2.25 million.
- (2) E.D.P. reports produced for management review do not highlight slow-moving or obsolete stocks.

2.28.1 Delays of up to 5 days are experienced in the processing of orders by the current computer. As a direct result of these delays it becomes necessary to retain an additional week's stock in order not to disrupt operations. Based on the 1983-84 average value of holdings (\$37.2 million) and average turnover (3.2) this delay represents an over-investment in stocks of approximately \$450 000 for each additional day's holdings.

2.28.2 Excessive stock holdings can result in slow-moving or obsolete items being retained and regular review of such items becomes essential. In this regard an EDP report is not produced for management which would highlight these items on a regular basis.

2.28.3 Recommendations

Audit recommends that a new on-line computer system, currently under development, be introduced as soon as possible in order to reduce processing delays.

Consideration should also be given to developing an EDP reporting application suitable for the identification of slow-moving/obsolete stocks.

2.28.4 Commission Reply

(1) The Commission agreed that the current computer system is inadequate and delays in processing could represent an over-investment in stock of between \$1.35 million and \$2.25 million.

(2) A report has recently been developed on the current computer system which identifies slow-moving and surplus stocks.

2.29 **Excess Holdings of General Purpose Material**

Observation

Established procedures for determining re-order points and re-order quantities are not operating as specified, with the result that there are excess holdings of general purpose material.

2.29.1 Re-order levels and quantities are determined in accordance with formulae and tables utilised throughout the SEC. The variables considered include economic order quantities, which correlate the costs of holding stock and of placing orders, turnover, unit price, estimated supply lead time, and minimum supply and pack size quantities. Other non-quantifiable factors such as seasonal trends and changing circumstances also are taken into consideration.

2.29.2 The stores manager advised that these procedures should result in an overall stockholding of approximately 13 weeks' stock or a turnover of 4 times a year.

2.29.3 For the 12 months period ended 30 November 1983 the turnover rate for general purpose material was 3.20 which is the equivalent of 16.25 weeks' stock holdings. If the stock holding was reduced to 13 weeks, with the same value of annual issues, then, based on the average value of stock on hand for 1983-84 of \$37.2 million, the investment in stocks would be reduced by \$7.44 million.

2.29.4 Recommendations

Audit recommends that re-ordering procedures be strictly complied with on a timely basis.

In addition, a survey should be undertaken of general purpose stock holdings with a view to reducing stock levels.

2.29.5 Commission Reply

The statement that the Commission is overstocked by a total of \$7.44 million is misleading as it is based on the premise of an overall optimal turnover rate of 4.0. This does not recognise that individual stores operate above or below this rate depending on the nature of material stocked. The 4.0 turnover rate is a rough "rule of thumb" measure. It does not take into account such factors as lead times, reserve stocks, materials requiring special purchasing treatment (e.g. poles, insulators and conductors), value of the finance suspense account and external factors such as the Electrical Trades Union dispute over the use of creosote poles (\$3.5 million).

The Commission's budgeted turnover rate of 3.36 takes these factors into account. Using the same formula, the inventory is overstocked by \$1.7 million. It is expected that this figure will be substantially reduced by 30 June 1984.

2.30 **Excess Holdings of Spare Equipment**

Observation

Spare equipment holdings in the Dale Street, Richmond storehouse are not regularly reviewed in order to identify surplus holdings.

2.30.1 For spare equipment and transformers which are of a specialised nature, the stores role is primarily that of custody, with decisions on items, quantities held and disposal being under the control of operations personnel. Storehouse managers advised that it is necessary to ensure that sufficient items are held to maintain essential operations with the minimum of disruption. Due to the variables of plant operations, many items could have low turnover or may not even be required during the life of the applicable plant for which they were held.

2.30.2 In order to prevent surplus and/or obsolescent stocks accumulating, most storehouses housing large stocks of spare equipment designate certain officers to perform regular reviews of holdings.

2.30.3 Audit established that regular reviews of holdings are not conducted at the Dale Street, Richmond storehouse which, at 30 November 1983, had spare equipment stocks valued at \$1.2 million.

2.30.4 Recommendation

An officer should be appointed to review spare equipment holdings, or alternatively, a program should be established to review each class of item on a regular basis.

2.30.5 Commission Reply

The recommendation that an additional officer be appointed to review spare equipment holdings at Richmond is not supported as it would be uneconomical to engage a specialist officer on this task. However, it is acknowledged that the review of spare equipment could be programmed in a better manner.

2.31 **Review of Surplus Materials**

Observation

A requirement that all storehouses submit schedules listing surplus materials is not being enforced. Absence of a review of such materials contributes to excess stock holdings.

2.31.1 Current procedures require storekeepers to follow a set program of reviewing different classes of items on a monthly basis with a view to establishing surplus holdings and/or obsolescence. Schedules listing items identified, or nil returns where appropriate, are required to be forwarded to Head Office for review each month.

2.31.2 Audit established considerable arrears of up to 5 years in receiving returns from a number of storekeepers.

2.31.3 Recommendations

- (1) For all major stores there should be direct follow-up when a monthly surplus materials schedule is not received at Head Office.
- (2) For the minor stores, surplus materials schedules should be forwarded to Head Office on a 6 monthly basis, with continuous reviews being conducted by supervisors as part of the regular stores inspection visits.

2.31.4 Commission Reply

The Commission agrees.

2.32 **Holdings of Reserve Plant and Project Material - Central Store**

Observations

- (1) The central store at Brooklyn houses large quantities of reserve plant and project material which require extensive storage facilities. The future usage of a significant proportion of this plant and material is uncertain.
- (2) Existing stores procedures provide little incentive for user departments to consider storage costs when premature purchases of materials are made.

2.32.1 Reserve plant items are items of used plant withdrawn from service, whereas project material is new equipment held pending usage on projects. For both classes of items the role of the storehouse is that of custody, with purchase decisions being made by user departments.

2.32.2 From a review of the storage areas at Brooklyn audit noted that there were significant numbers of both reserve plant and project material items, both under-cover and outside. The appearance of many of the reserve plant items indicated that they had been situated there for several years. Apart from storage costs, the retention of reserve plant for which future usage may be uncertain represents an inefficient use of capital resources.

2.32.3 User departments are not required to contribute to storage costs under existing stores procedures. As a consequence, there is little incentive to minimise storage periods for project material items pending transport to sites.

2.32.4 Recommendations

- (1) User departments should be required to review all items of reserve plant and to specifically identify future usage. Surplus plant should be disposed of.
- (2) Consideration should be given to imposing a rental charge on user departments in order to discourage the unnecessary holding of reserve plant items and the premature purchase of project material.

2.32.5 Commission Reply

Owners of various items held at Brooklyn (and elsewhere) are periodically asked to review the need to retain items of reserve plant. Generally, results are disappointing. A current project is to investigate the viability of a charge-out system for storage facilities.

2.33 **Stocktaking Policy**

Observation

Existing stocktaking procedures are not cost effective.

2.33.1 The Commission stocktaking policy is that all items are to be counted at least annually with attractive items such as electrical appliances, tools and clothing being counted quarterly and high turnover items being counted 2-3 times per year. Criteria such as nature of item, value, and existing security, are not always taken into consideration when the frequency of checking is determined.

2.33.2 Recommendation

In audit opinion it would be desirable to introduce programmed interim stock counts taking into consideration matters such as value, nature, turnover and security arrangements.

2.33.3 Commission Reply

The Commission agrees. Stocktaking procedures are currently under review.

GAS AND FUEL CORPORATION

OVERVIEW OF STORES OPERATIONS, POLICIES AND PROCEDURES

2.34 The Corporation's major activities are directed towards the distribution of natural gas and liquid petroleum gas, the sale of appliances, and petroleum exploration.

2.35 The functions of the Corporation's stores department have been defined in the stores department Standard Procedure Manual as follows:

"to procure, receive, store and issue materials for the Corporation's requirements, and to maintain stocks in sufficient quantity to ensure continuity of operations while restricting holdings to the minimum consistent with economical supply arrangements".

2.36 For the year ended 30 June 1983 the department processed over 1.1 million transactions while total operating costs were \$5.6 million. Staff establishment for the department in the year was 211 employees.

2.37 Inventory value at 30 June 1983 was \$22.7 million and comprised the following:

	\$M
Technical Material	12.8
Appliances, Parts and Accessories	9.3
Miscellaneous	0.6

	22.7

2.38 Approximately 50 per cent of the Corporation's inventory is stored at its bulk store in Clayton, with smaller inventories being held at other stores located throughout the metropolitan and country areas. In addition, a significant amount of appliance stocks, mainly for display purposes, is held at the Corporation's 88 branches and agencies.

SUMMARY OF MAJOR AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.39 The significant audit observations and recommendations concerning the operations of the Corporation's stores function were:

- (1) Procedures for the identification of slow moving stocks are inadequate and have contributed to significant holdings of potentially surplus and obsolescent stocks.

Audit recommends that there be a more intensive review of slow moving stock items.

(2) Appliance inventory holdings are significantly affected by Corporation marketing decisions regarding:

- the wide range of appliance models stocked by the Corporation; and
- the relatively high level of showroom display stock maintained at Corporation branches and agencies.

Audit recommends that the Corporation consider a rationalisation of the range of appliance models held in stores and branch and agency showrooms.

(3) A wide range of manufacturers' appliances, spare parts and accessories is being maintained.

Audit recommends that the Corporation reassess the necessity for these high stock levels which are normally regarded as a manufacturer's responsibility.

AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.40 Review of Slow Moving and Obsolescent Stock

Observation

Present procedures for the identification of slow moving stocks are inadequate and have contributed to significant amounts of potentially surplus and obsolescent stocks being held in the Corporation's inventory.

2.40.1 The Corporation has a general practice of carrying a maximum 3 months stock of most items at any time, the exception being where materials, e.g. piping stock, are held as emergency or reserve stock purely as insurance against possible disaster situations.

2.40.2 The audit review established that the Corporation placed substantial reliance on the use of "no movement" reports to identify slow moving stocks. The "no movement" reports list technical material stocks that have shown no movement for 12 months and, similarly, appliance stocks that have not moved for 6 months. The lists are sent to user departments for explanation as to reasons for non-movement and likely future requirements. Items not required may be declared surplus or obsolete, in which instance disposal action is taken.

2.40.3 Reviews of other slow moving stock items not identified in "no movement" reports are carried out only when re-order levels are reached or general re-order parameter reviews are conducted.

2.40.4 While acknowledging that non-movement reports are useful in identifying "slow" stock, an inadequacy existed in that the reports did not identify items which were slow moving in relation to existing stock levels. For example, if only one issue of a particular stock item was made during a 12 months period, this fact would not be highlighted by such reports.

2.40.5 Following audit consultation with the Corporation's stores department, an EDP report was produced which identified items for which existing stock levels represented greater than 12 months' usage (usage being defined as average monthly issues for the last 12 months).

2.40.6 This report, which will now be produced at regular intervals by the stores department, indicated that there is a need for more intensive Corporation review of slow moving items. In particular it was noted that, of the Corporation's total stockholdings of \$20.4 million at 30 November 1983, some \$4.55 million (22.6 per cent) related to stock items where existing holdings exceeded the item's last 12 months' usage. Included in this figure was:

- \$0.85 million (4.2 per cent of total holdings) relating to stock items having no issues at all during the previous 12 months, including \$0.3 million with no issues during the previous 24 months;
- \$1.5 million (7.4 per cent of total holdings) relating to piping stock and material held as emergency or reserve stock (refer para 2.40.4).

2.40.7 Individual examples of slow moving items that in audit opinion require further Corporation review include:

(1) LPG Auto Conversion Kits

Kits with a total value of \$226 000 were held in stock which, based on current usage, represented nearly 3 years' supply.

(2) Appliances

The Corporation periodically holds sales to dispose of slow moving or superseded appliances. Despite this action, audit identified \$34 000 worth of appliance catalogue items that had not moved for at least 2 years, while certain other appliances showed minimal movement (refer para 2.41).

(3) Technical Material

A number of items identified as slow moving have had their usage demand reduced by technological change whilst holdings of other items appeared excessive when related to current usage. As an example, it was found that approximately 9 years' supply of high pressure pipe valued at \$151 184 was on hand.

2.40.8 It is recognised that many slow-moving technical items are being held in inventory for capital works projects or as emergency or reserve material. However, in audit opinion the number and value of slow moving items in the Corporation's inventory indicates there is a need for further review of these items, particularly in relation to criteria such as expected future usage, stores handling and holding costs, potential sales proceeds etc.

2.40.9 Recommendation

There is a need for more intensive Corporation review of slow moving stock items. Such a review should provide the Corporation with scope for a reduction in investment funds tied up in the holding of stocks.

2.40.10 Corporation Reply

Procedures for the identification of slow moving stock have been developed and are now in use.

Individual examples of slow moving technical material and LPG auto conversion kits referred to are under continuous review and the Corporation is examining the potential for their use in other applications. Many of the appliances referred to are for display purposes and are variations of models not normally held in stock. It is Corporation policy to present a wide range of appliances for gas customers to review.

2.41 **Appliance Stocks**

Observations

- (1) Appliance inventory levels, particularly for showroom display purposes, appear excessive.
- (2) Unrealised sales demand forecasts for certain appliances have resulted in surplus holdings.
- (3) In certain agencies appliance sales turnover, relative to the level of showroom stock maintained, is exceedingly low.

2.41.1 Orders for appliances are usually placed with manufacturers on a monthly basis after consideration of sales forecasts. These forecasts are dependent upon such factors as recent sales history, market research and seasonal usage.

2.41.2 However, the Corporation also engages in bulk buying of appliances when it anticipates:

- large customer demand in sales campaigns; and
- quantity discounts will offset holding costs.

2.41.3 The benefits of this course of action depend heavily on the accuracy of the sales forecast.

2.41.4 It was apparent that certain sales forecasts proved to be inaccurate and have resulted in the holding of surplus and potentially obsolescent stocks. Examples include:

<u>Description</u>	<u>Qty. On Hand</u>	<u>Average Monthly Issues</u>	<u>Estim. Supply Held (Months)</u>	<u>Value \$</u>
LPG Cooker	74	4.25	17	45 096
LPG Cooker	134	6.33	21	54 152
LPG Barbecue	313	16.33	19	28 517
LPG Room Heater	145	6.83	21	36 772
LPG Space Heater	77	5.91	13	29 075
NG Hot Water Service	63	1.75	36	21 239

2.41.5 It was noted that of the Corporation's \$7.9 million of appliance stock held at 30 June 1983 approximately \$3.0 million (38 per cent) was held in Corporation branches and agencies throughout Victoria.

2.41.6 The large levels of stock holding in branches and agencies are partly reflected in some instances in poor annual stock turnover rates varying between 1 and 2 per cent. As an example, the Windsor agency had stocks on hand valued at \$27 596 at 30 June 1983, while annual turnover was only 1.93 per cent.

2.41.7 Factors which contribute to high appliance inventory levels are:

- (1) Corporation policy to attempt delivery of 95 per cent of appliances sold within 5 days of purchase. As a consequence of this policy high levels of stock need to be maintained in order to ensure customer satisfaction.
- (2) The Corporation's sales policy is to present to customers in the showrooms a comprehensive display of the varying manufacturers' models available. In many instances the variation between models is minor e.g. colour or type of ignition.
- (3) Generally, appliances sold are supplied from the Clayton bulk store. However, significant "buffer stocks" are also retained in branches and agencies in order to satisfy "on the spot" sales.

2.41.8 In audit opinion the value to the Corporation of maintaining high inventory levels at the various branches and agencies needs to be evaluated in terms of sales revenue, as compared to the levels of inventory required and the costs thereof.

2.41.9

Recommendations

- (1) The Corporation should consider a rationalisation of the range and level of models held, with a view to reducing its appliance inventory levels.
- (2) In situations where surplus appliance stocks are identified, prompt disposal action, e.g. discounting prices, should be effected.

2.41.10

Corporation Reply

The Corporation is the largest retailer of gas appliances and provides the only comprehensive display of these appliances to the public of Victoria.

In purchasing appliances for a campaign the Corporation orders what it believes to be the correct mix of makes and models. While the Corporation normally achieves its campaign targets there are always a few models that do not sell as well as expected. The appropriate marketing department then undertakes special promotional activity during the next campaign to quit the stock.

Appliance sales have a seasonal bias and the major reason for having slow moving stocks is the manufacturers' inability to deliver the stock on time. Stock that is finally received late in a campaign or season generally becomes "slow moving" until cleared during the following season.

2.42

Appliance Parts and Accessories

Observation

The Corporation retains significant stocks of appliance spare parts and accessories by comparison with the usual commercial situation where responsibility for such stock rests with the manufacturer.

2.42.1 At 30 June 1983 the Corporation was holding stocks of replacement parts and accessories valued at \$1.3 million. Holdings are generally maintained in sufficient quantities so as to provide service on appliances for at least 10 years after date of last manufacture.

2.42.2 Audit noted that the appliance manufacturers also are required to hold stocks for this 10 year period, such requirement being necessary for membership of the Australian Gas Manufacturers Association.

2.42.3 A significant part of the Corporation's activities is devoted to the repair and maintenance of appliances. Audit was advised that the Corporation's reason for maintaining a large stock of appliance spare parts relates principally to the service role provided to the gas consumer by the Corporation; in particular to ensure that consumers' gas appliances are adequately maintained and serviced.

2.42.4 Recommendation

In audit opinion there is a need for the Corporation to re-assess its role as to the holding of appliance spare parts and accessories. Although the Corporation has a wider community role than an ordinary appliance retailer, the holding of spare parts for manufacturers' appliances is basically the manufacturers' responsibility.

2.42.5 Corporation Reply

The Corporation considers that there is a joint responsibility with manufacturers for the stocking of appliance spare parts and accessories. A readily available supply of parts is essential to support the Corporation's service division and sub-contractors.

A review is currently being carried out with a view to rationalising the range and level of stock holdings.

2.43 **Performance Evaluation Measures**

Observation

Stores performance evaluation criteria have been developed by the Corporation but benchmarks suitable for monitoring actual performance have not been established.

2.43.1 The Corporation has developed extensive stores performance evaluation criteria, such as turnover and operating cost ratios, individual transaction costs and number of transactions per employee. Analyses conducted generally relate to comparisons of current performance results against those of prior periods.

2.43.2 In audit opinion the value of such analyses is limited unless comparisons can also be made against performance benchmarks established by the Corporation, after reviewing comparable industry standards and similar operations in other States.

2.43.3 Recommendation

To assist in the effective monitoring and evaluation of stores operations and to gauge whether services are being provided as efficiently as possible, audit recommends that formal benchmark objectives be established by the Corporation.

2.43.4 Corporation Reply

The Corporation intends establishing benchmarks using a range of turnover ratios appropriate to each group/item of inventory.

2.44 Stockchecking Frequencies

Observation

Stockcounts are generally conducted at annual intervals only. Programmed interim counts according to criteria such as item value, turnover and nature are not carried out.

2.44.1 Cyclical counts are carried out annually at Corporation stores whilst counts at branches and agencies are generally conducted at intervals of 9 months. In addition, a limited number of random counts are conducted at the Clayton store.

2.44.2 Stocktaking discrepancies during the last 2 financial years have been related largely to appliance shortages at the Clayton store. Such discrepancies have been relatively minor when compared with the Corporation's turnover and total holdings.

2.44.3 In audit opinion it would be more efficient and cost effective for the Corporation to introduce programmed interim stockcounts, particularly for appliance stocks. When programming stock counts, consideration should also be given to the weighting of items according to value, nature and turnover.

2.44.4 Recommendation

There is a need to introduce programmed interim stock counts, particularly in relation to the more important stock items.

2.44.5 Corporation Reply

The Corporation agreed with the audit recommendation. The Clayton bulk store is being re-organised as to racking and general layout in a manner which will significantly assist in more effective stock counting procedures.

STATE TRANSPORT AUTHORITY

OVERVIEW OF STORES OPERATIONS, POLICIES AND PROCEDURES

2.45 In accordance with the provisions of the Transport Act 1983, the Victorian Railways Board was abolished from 1 July 1983 and its resources and activities, including stores operations, were taken over by the State Transport Authority.

2.46 The Authority's stores system is based on a "parent" storehouse concept. Under this concept "parent" storehouses are responsible for the purchasing and/or manufacture of items in order to maintain sufficient stocks to enable immediate supply of material to other storehouses.

2.47 Major stores operations are conducted at 7 metropolitan and 3 country locations. In addition, there are 64 subsidiary stores located throughout metropolitan and country areas. These stores are responsible for some 54 000 stock items and total issues during 1982-83 amounted to approximately \$76 million.

2.48 Inventory value at 30 June 1983 was \$12.6 million and comprised the following:

	\$M
Rolling stock construction and maintenance material	5.7
Electrical distribution construction and maintenance material	2.9
General purpose equipment	1.6
Rail, points and crossings, sleepers	1.4
Fuel	1.0
	<hr/>
	12.6
	<hr/>

2.49 During 1982-83 an average of 464 personnel were employed in stores operations and payroll costs were approximately \$7 million.

2.50 Stores branch operations are directed towards providing a maximum level of service to the various branches within the constraints of minimal stock investment and operating costs. To assist in the monitoring of operations the Authority has developed performance evaluation criteria relating to turnover ratios by item and store, volume of transactions, and operating costs as a percentage of the value of issues.

SUMMARY OF MAJOR AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.51 The major audit observations and recommendations arising from the review of the Authority's stores operations were:

- (1) Excessive funds are invested in stores which are either obsolete, slow moving, or surplus to foreseeable demand.

Audit recommendations relate to:

- review of production planning procedures, including the need to estimate annual stock requirements in advance;
- review of accounting policies which act as a disincentive to the review of slow moving/obsolete items; and
- the need for a computer reporting application to assist in the prompt identification of slow moving/obsolete items.

- (2) Duplication of stores information has resulted in additional operating costs and inefficient use of manpower resources.

Audit recommends that the existing stores recording system be replaced as soon as possible with an on-line computer system capable of providing inventory information and related management reports on a timely basis.

- (3) Project delays and failure to incorporate project material, including material surplus from projects, in the inventory system has contributed to excessive levels of holdings.

In audit opinion project material, including surplus holdings, should be incorporated in computerised inventory records in order to maintain total stock control. Ordering procedures in relation to project commencement dates also require review.

AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.52 Obsolete, Slow Moving and Surplus Stock

Observation

Excessive funds are invested in stores which are either obsolete, slow moving or surplus to foreseeable demand.

2.52.1 A detailed analysis of stock holdings of \$14.2 million at 15 October 1983 established that \$1.7 million (11.9 per cent of total holdings) related to stock items having no issues during the past 12 months, including \$0.8 million with no issues during the past 2 years. The last recorded issue of certain items dated back as far as 1974.

2.52.2 Although the average turnover rate was in excess of 5 times per annum, approximately half of the total inventory, valued at \$6.9 million, related to items with a low turnover rate of less than twice a year. More than 5 years' supply existed for a number of items with a total value of \$774 889.

2.52.3 Factors contributing to low turnover rates and excessive levels of inventory were:

(1) Production Planning Procedures

To ensure continuity of operations, substantial stocks are retained of certain items manufactured in the Authority's workshops. This situation can be attributed to orders being placed with workshops on an ad hoc basis, causing delays of up to 6 months in obtaining delivery of certain items e.g. castings. Workshops are reluctant to start production runs until orders reach economic levels. In audit opinion delays would be substantially reduced if workshops were advised of annual requirements in advance, thus enabling a scheduled production program to be developed.

(2) Accounting Policy in Relation to Write-Offs

Since 1978-79 a policy has been followed where, if a stock item has not moved for a minimum 12 months period, depreciation is applied on a selective basis of 25 per cent after the first 12 months period, followed by a 50 per cent write down of the residual value in each subsequent period of non-movement. Additionally, ad hoc write downs may be authorised. An amount of \$764 761 was written off stock values in 1982-83, bringing the total value of write offs since 1978-79 to approximately \$1.7 million.

As a consequence of this policy, significant quantities of slow moving/obsolete stocks are being retained, although recorded at low values, which can lead to:

- lack of incentive for user departments to reduce physical stock;
- overstating turnover rates;
- understating reported stock values;
- incorrect/understated charging at the time of issue;
- failure to highlight incorrect stocking decisions.

(3) Review procedures - obsolete and slow moving stock

A Stores Standardisation Committee, comprised of representatives from every technical branch, meets every 2 months to review stores classifications and procedures. This committee is also responsible for the review of slow moving/obsolete items and it was noted that the last major review of obsolescent items was conducted in 1981. Recommendations arising from this review have apparently not been acted upon, as certain stocks identified were found by audit to be still on hand at the Newport storehouse. A review of items with more than 3 years holdings commenced in August 1981 and is still in progress.

The committee relies upon storehouse managers to advise of slow moving/obsolete stocks and for this purpose a report is produced which highlights items that have not moved within a 12 months period. The value of such reports is limited as items for which single or minimal issues were made will not be highlighted in the reports, and will not be reviewed.

User department approval is required before obsolete items can be scrapped. As user departments are not required to contribute to storage costs there is a general reluctance to take such action, usually on the premise that potentially obsolete items "may be required one day".

2.52.4 Recommendations

- (1) A review of production planning procedures should be made with a view to reducing delivery delays which contribute to overstocking.
- (2) Accounting policies relating to the writing down of slow moving items require review.
- (3) An EDP reporting application should be developed to identify slow moving items in relation to existing stock levels. Such a report should be regularly reviewed by storehouse managers and user departments and, where appropriate, items identified should be brought to the attention of the Stores Standardisation Committee.
- (4) In order to create a greater awareness of holding costs associated with slow moving/obsolete stocks, audit recommends that responsibility for such costs be transferred to user departments. Consideration could also be given to authorising the Store Comptroller to dispose of stocks in certain circumstances without the authority of the user department.

2.52.5 Authority Reply

- (1) A system advising workshops of requirements is already in use. However, a review will be undertaken of production planning procedures.
- (2) The practice of writing down items which have not moved over a 12 months period will be reviewed, including formulation of a policy on disposal of obsolete stock.
- (3) A new on-line computerised stores system to be introduced in 1984 is expected to enhance procedures for the review of stock holdings.
- (4) The Authority is proposing to transfer warehousing controls, including inventory responsibility, to the operating division, so as to make the user more accountable for the cost of stock.

The matter of disposal action by the supply manager will be considered as part of the review of write-off policies.

2.53 Stores Recording System

Observation

Duplication of stores information has resulted in additional operating costs and inefficient use of manpower resources.

2.53.1 The central computer system is used to monitor stock levels and to produce management reports on stores usage.

2.53.2 Manual records relating to stock levels are also maintained by storemen on bin cards and on cards held for re-ordering purposes. Similar information on stock control is also available on mechanised accounting records maintained in storehouses at Spotswood, Ballarat, Bendigo, and Geelong.

2.53.3 In audit opinion the recording of identical stores information in at least 4 places results in excessive operating costs and inefficient use of manpower resources.

2.53.4 Recommendation

Audit recommends that the existing stores recording system be replaced as soon as possible with an on-line computer system capable of providing inventory information and related management reports on a timely basis.

2.53.5 Authority Reply

It is expected that cost savings of at least \$270 000 will be achieved in the first year of operation of an on-line stores computer system to be introduced shortly.

2.54 Holdings of Project Material

Observation

Project delays and failure to incorporate project material, including surplus requirements, in the inventory system have contributed to excessive levels of holdings.

2.54.1 Project material is material purchased by a user department for a specific works project and is not processed through the normal inventory system. Although material may be held in storehouses pending usage on projects, the storekeeper has minimal control over such holdings and records physical movements only.

2.54.2 Order quantities of project material are determined by a department according to individual project requirements, with delivery dates being scheduled close to the expected project commencement date.

2.54.3 Surplus materials from specific projects are subject to review by user departments to establish whether they should be transferred into stock, allocated to other projects or disposed of.

2.54.4 The practice of excluding project materials from the inventory system prevents an overall assessment of material holdings in relation to works requirements. In addition, materials are not subject to regular review by storekeepers as to level of holdings, value, and slow-moving/obsolete items.

2.54.5 Other factors are:

- (1) Material purchases are made only in relation to specific project requirements. Sufficient regard may not be given to materials already in inventory, stocks held on behalf of delayed projects, or surplus materials from completed projects. As an example, audit established in November 1983 that the Newport store was holding cable valued at \$600 000 which had been purchased for specific projects. At that time stocks of identical cable valued at \$124 000 were available from inventory.
- (2) Delays in project commencement dates are not always relayed to purchasing officers which means that funds are expended on project materials which may not be required for some time. In audit opinion this leads to inefficient use of financial resources, as well as contributing to excessive holdings and increased storage costs. Audit identified project material on hand in the Newport store that related to projects with advised commencement dates extending back to July 1980.
- (3) Reviews of surplus project materials are not conducted at regular intervals by user divisions. As a result, orders may be placed for inventory items that are being held as surplus material in other stores and excessive levels of obsolete material may also be retained. An audit inspection of the Spotswood store revealed substantial quantities of material which were surplus from completed projects.

2.54.6 Recommendations

- (1) Project material should be included as part of the established inventory recording system. This is considered necessary in order to:
 - provide a true assessment of the total investment in stock on hand and maintain total stock control;
 - enable management to more adequately monitor project material holdings and ordering decisions of user divisions in order to prevent a build up of material surplus to current requirements.

- (2) Project material holdings, including surplus materials, should be regularly reviewed in the light of future requirements and, where appropriate, disposal action should be taken.
- (3) Ordering procedures for project material require review, particularly in relation to project commencement dates upon which deliveries are based.

2.54.7

Authority Reply

Financial accountability of project material and surplus stock has been provided for in the new stores system.

Policy changes, involving project priority and the postponement of projects can in some cases lead to the holding of high stock levels. A review of ordering procedures will be undertaken.

EDUCATION DEPARTMENT

OVERVIEW OF STORES OPERATIONS, POLICIES AND PROCEDURES

2.55 The Education Department operates a central store at Collingwood, primarily for the purpose of supplying equipment, printing material, stationery and other items to government schools. In addition, the store supplies stationery to government departments and science equipment to a number of private schools.

2.56 Inventory value at 30 June 1983 was \$2.1 million and annual turnover was in the vicinity of \$7.2 million. During 1982-83, 73 personnel were employed in stores operations and payroll costs were approximately \$1.3 million.

SUMMARY OF MAJOR AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.57 The major audit observations and recommendations arising from the review were:

- (1) Failure by government schools to utilise education allowances in obtaining all stock items from the Education Department store has resulted in additional costs to parents and school councils estimated at up to \$10 million during 1983-84, depending on the items purchased and the discount negotiated by the school councils.

Audit recommends that, where possible, government schools be required to purchase all stock items from the central store.

- (2) Excessive funds are invested in slow moving/obsolete stocks.

Audit recommends that slow moving/obsolete stocks be regularly reviewed and disposed of where appropriate. The prompt identification of such items would be enhanced by the development of an EDP reporting application.

AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.58 Purchasing by Government Schools

Observation

The actions of school councils in applying education allowances towards the purchase of stock items from sources other than the Education Department store has resulted in additional costs to councils and parents of up to \$10 million during 1983-84, depending on the items purchased and the discount negotiated by the school councils.

2.58.1 The main objective in operating the central store is to provide government schools and departments with a ready source of supply of requisites at minimal price. However, as a result of the autonomy given to school councils, education allowances can be used to purchase stock items from independent suppliers.

2.58.2 The value of education allowances for 1983-84 amounted to \$36.5 million. Based on the assumption that approximately one third of the education allowance is required for books, approximately \$24 million would be available for items of the type supplied from the store. Cash sales to government schools from the central store during 1983-84 amounted to only \$2.2 million.

2.58.3 As items available from the store generally cost from 20 to 45 per cent less than normal retail prices, savings forgone as a result of purchases from independent suppliers are estimated at up to \$10 million during 1983-84, depending on the items purchased and the discount negotiated by the school councils. Substantial savings could still be achieved even if prices were increased by the 27 per cent necessary to recoup operating costs (refer para. 2.60.3).

2.58.4 More extensive utilisation of the store could result in further savings from bulk purchasing of standard items.

2.58.5 Recommendation

Consideration should be given to encouraging school councils to recommend the purchase of stock items from the central store.

2.58.6 Departmental Reply

In 1983 the Minister of Education established a Committee to review the purpose, administration and level of education allowances. The Committee is aware of the discretion afforded schools in their purchase of school stationery items. The thrust of Education policies favours more autonomy for schools in relation to curriculum and operational matters.

Pricing differentials were acknowledged, although it was considered that some schools have developed arrangements with suppliers which rival terms available through the store.

2.59 **Slow Moving/Obsolete Items**

Observation

Significant funds are invested in slow moving/obsolete stocks.

2.59.1 The Department has taken action over the past 2 years to reduce the value of inventory from \$4 million to \$2.1 million at 30 June 1983. Despite this action, audit established that over 8 per cent of inventory (value at 30 June 1983, \$168 000) represented stock for which over 3 years' supply existed. Examples of these excess holdings were:

<u>Item</u>	<u>Quantity on Hand Nov. '83</u>	<u>Value \$</u>	<u>Average Issues Per Annum 1981 -1983</u>	<u>No. of Years Supply Held</u>
Applicators for floor polish	25 323	45 581	1 848	13
Electric field in electrolytes kit	535	3 603	29	18
Bottle Dreshel, 125 ml.	1 485	4 444	20	74
Semi Micro-Kit, Natural Gas	364	8 278	14	26

2.59.2 Current procedures for the review of slow moving/obsolete items involve identifying items on an EDP report for which issues were minimal over a 3 year period. In audit opinion this system is inadequate due to:

- (1) the time factor involved in reviewing over 2 500 stock lines; and
- (2) the turnover ratios for individual items, or items for which there were no issues, not being highlighted on the EDP report.

2.59.3 Recommendation

To assist with the identification of slow moving/obsolete items, consideration should be given to developing an EDP reporting application which will highlight items for which stock turnover was less than pre-determined levels.

2.59.4 Departmental Reply

The over-investment of \$168 000 reflects original costs and relates to pre-1979 conditions of stock procurement. Most of the items concerned would have a low disposal value. As such, the over-investment, in current terms, would be significantly less than \$168 000. Pursuant to audit comments, action is being taken to have the items declared in Boards of Survey.

An EDP report will be developed in order to highlight excess stock levels.

2.60 Cost Recovery

Observation

The full cost of stores operations is not recouped in sales revenue.

2.60.1 In accordance with the "user pay" principle the cost of stores operations should be recouped from sales revenue. At present there is only partial recovery of operational costs with a maximum service fee of \$10 being added to the value of all goods supplied from the central store.

2.60.2 The consequences of failure to fully recoup operating costs are:

- (1) financial statements prepared by schools and government departments do not accurately reflect the real cost of stock purchases from the central store; and
- (2) purchases by private schools of science supplies from the store are being effectively subsidised by the Education Department.

2.60.3 Recovery of operating costs would require an additional margin of approximately 27 per cent to be added to current selling prices. As the store currently offers price savings of up to 45 per cent this margin should not significantly affect the price advantage the store has compared to commercial operations.

2.60.4 Recommendation

Pricing structures should be revised in order to recoup operating costs.

2.60.5 Departmental Reply

As around 85 per cent of supplies involve government schools, an increase in the overhead charge to 25 per cent would necessitate the Department supplementing school funding by approximately \$1.02 million for schools to be able to purchase equivalent supplies. The Department would prefer to have the views of the Department of Management and Budget on the likelihood of additional funding before taking this matter further.

2.61 **Performance Evaluation Measures**

Observation

Performance evaluation measures currently in operation are not sufficient for management to monitor the efficiency and effectiveness of stores operations.

2.61.1 Stores performance evaluation measures currently used by the Department relate to annual reviews of supply times, operational costs, stock turnover, sales value and volume, and stock availability. While of assistance, these measures alone are insufficient to effectively monitor stores operations due to:

- (1) performance comparisons relating to the results of previous years and not to benchmark objectives formally established by management;
- (2) the infrequency of reporting which can result in failure to identify and correct problem areas at an early stage; and
- (3) not all aspects of stores operations being covered. Additional measures could include transactions per store employee, cost of operations relative to holdings and issues, and identification of slow moving stock.

2.61.2 Recommendation

Additional performance evaluation measures, including the establishment of formal benchmark objectives, should be introduced and reviewed on a regular and timely basis by senior management.

2.61.3 Departmental Reply

The Department advised that reports identifying slow moving stocks were now available and will be utilised. It would be prepared to introduce the monitoring of operational costs and consideration would be given to the practicability of monitoring transactions per employee.

2.62 **Stockchecking Frequencies**

Observation

Existing stockchecking procedures are not cost effective.

2.62.1 Stock counts of all items in the central store are conducted half-yearly whilst certain attractive items, e.g. cassette recorders, are counted monthly. A limited number of spot checks are also conducted.

2.62.2 The cost effectiveness of conducting counts in this manner is doubtful, especially in view of:

- (1) attractive items being kept in a locked storage area; and
- (2) manpower requirements and costs thereof; following the stocktake at 30 June 1983, 180 man days were spent in attempting to resolve discrepancies totalling only \$3 131.

2.62.3 Recommendation

In audit opinion it would be more efficient and cost effective to introduce programmed interim stock counts according to criteria such as nature of item and value, turnover, and existing security.

2.62.4 Departmental Reply

The Department agrees that the check of attractive items on a monthly basis may not be cost-effective having regard to the nature of existing security. The checks will be carried out every 3 months in future. However, it considers that the twice yearly checks of all stocks during school vacations should continue.

The Department plans to continue with the progressive "spot" checks, particularly in relation to stocks which may have been subject to higher-than-average error conditions, as disclosed by the periodical full stocktaking.

2.63 **Re-Order Procedures**

Observation

Re-ordering criteria do not adequately take into account the costs of ordering and of holding stocks.

2.63.1 As a stock list item drops below re-order level a decision regarding replenishment is made by the purchasing officer. The factors considered in making these decisions are: current demand trends, demand at the equivalent time last year, a pre-determined figure for 3 months requirements, and the lead time.

2.63.2 Re-ordering decisions are therefore based only on factors relating to estimated usage and do not adequately take into account the costs of ordering and holding stocks. In addition, there has been no recent review of existing re-order criteria.

2.63.3 Recommendation

Re-ordering criteria should be revised to adequately take into account the costs of ordering and holding items. Once established, economic order quantities should be reviewed on a regular basis.

2.63.4 Departmental Reply

The Department does not agree that re-ordering procedures fail to take into account other important indicators, particularly as they may relate to and prevent excessive stock holdings. When establishing economic order quantities full regard is had to:

- curriculum changes which may impact on current stock holdings;
- 3 years' moving average of stock usage for all items up for re-order;
- lead times, having regard to the special seasonal factors which influence the demand and supply of items to schools; and

- discounts which may be available towards the end of a period contract, special price offers, etc.

2.63.5

Audit Comment

Of the factors mentioned in the Department's response, only the last has any relevance to economic order quantities. None of the factors has any direct relevance to costs of ordering and holding stocks.

VICTORIAN GOVERNMENT PRINTING OFFICE

OVERVIEW OF STORES OPERATIONS, POLICIES AND PROCEDURES

2.64 The Government Printing Office, which forms part of the Department of Property and Services, is responsible for providing publishing, printing, marketing, selling and distribution services to Parliament, government departments and some statutory authorities.

2.65 The Office manufactures a wide range of printed material including legislation, books, stationery and forms. Approximately 16,000 production orders are received annually with some 80 per cent being required to be manufactured to specifications on an order by order basis. The other 20 per cent of orders are for standard types of work which have been produced previously.

2.66 The stores function is essentially related to the maintenance and adequate supply of:

- raw material, mostly paper products, used in the production processes; and
- stationery and publications held for resale.

2.67 At 30 June 1983 there were 40 employees in stores operations and salaries and wage costs were approximately \$700 000. Operational costs are recouped as part of the selling margin on sales.

2.68 The Office has a bulk store at Maribyrnong which is used primarily to replenish paper and stationery stock at the printing works complex in North Melbourne and publications at the Public Offices Branch in East Melbourne. Inventory value at 30 June 1983 was \$3.37 million.

SUMMARY OF MAJOR AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.69 The major audit observations and recommendations concerning the operations of the Office's stores function were as follows:

- (1) Weaknesses in stock recording and control procedures have resulted in unreliable and inaccurate information being used in re-ordering decisions. Major weaknesses identified were:
 - incorrect recording of stock movements and balances in inventory records;
 - inadequate stockchecking frequencies.

Audit recommends that appropriate action be taken to ensure inventory records are accurate and reliable and that the stores computer system be enhanced to meet user requirements.

- (2) Inadequate review procedures have resulted in excessive funds being invested in slow moving/obsolete inventory items, particularly in relation to publications where certain individual holdings represent many years of current usage.

Audit recommends that a review of slow moving stock holdings be carried out with a view to reducing inventory levels.

AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.70 Inventory Records

Observation

Inventory records maintained in the stores computer system are often inaccurate, which impacts upon re-ordering decisions.

2.70.1 Examination of inventory records relating to paper and stationery stocks disclosed that of a total number of 460 items, some 52 items (11 per cent) were recording negative stock quantities. Audit established that discrepancies between ledger quantities and physical stocks has been an ongoing problem at the Office for many years.

2.70.2 These discrepancies have resulted from a combination of the following factors:

- (1) Incorrect input on stores transaction documents, such as the recording of incorrect stock item numbers.
- (2) Lack of physical control over stock movements. Access to the North Melbourne paper store was readily available to night shift production staff in order to obtain paper stocks. "Materials issued" vouchers and returns to stock were not always recorded.
- (3) Delays of up to a month in the recording of certain stationery store issues, particularly in relation to the Education Department.

2.70.3 Reliance was generally placed by the Office on the accuracy of the stock ledger when re-ordering decisions were made. As such, discrepancies on ledger records resulted in overstocking, understocking and out of stock situations.

2.70.4 By way of example it was noted that the printing of the Government Printing Office's 1984 strawboard backed calendar was delayed when the Stores Control Officer discovered that when this production job was due to commence the store was only holding approximately 200 strawboard sheets and not the 4 000 sheets indicated by the records.

2.70.5

Recommendations

Appropriate corrective action should be instituted to ensure that inventory records are accurate and reliable. In particular, audit recommends that the Office:

- ensures immediate follow up of negative stock ledger quantities;
- ensures that access to the North Melbourne paper store is controlled;
- records Education Department stationery issues upon despatch;
- institutes measures to significantly improve the accuracy of stores input documents;
- undertakes an immediate stock count of all items in order to establish actual stock quantities. Approval under the Department of Management and Budget Regulations 1981 should then be sought as soon as possible in order to adjust for any stock discrepancies found.

2.70.6

Office Reply

Documentation of inwards goods to Paper and Stationery Stores has been expedited by requiring Materials Received Vouchers to be initiated by the receiving store rather than by the Inwards Goods Officer. This will eliminate many problems with negative balances and apparent discrepancies.

Access to the North Melbourne Paper Store by night shift staff was terminated and a stock count was effected to establish actual stocks on hand.

Distribution of stationery to the Education Department is to occur on an annual basis and issues will be recorded upon despatch.

2.71

Inventory Re-order Procedures - Paper and Stationery

Observations

- (1) Re-order reviews in relation to paper (raw material) items are not always timely, being carried out monthly at most.
- (2) The Stores EDP system lacks the facility to identify stock items low in quantity, for which orders have already been placed. Absence of this facility could result in duplication of orders and overstocking.

2.71.1 Re-order decisions for paper and stationery items are based on a weekly EDP report which itemises stock lines that have dropped below re-order points. Audit noted that these weekly reports are reviewed on a monthly basis at the most, a practice which, taken in conjunction with the long lead time for delivery required by many suppliers, could result in out-of-stock situations.

2.71.2 Due to the inaccuracy of stores ledger records, the true extent of the out-of-stock position could not be assessed readily by audit. However, a review of the EDP report produced on 17 November 1983 indicated that stocks were not on hand for 73 paper and stationery items.

2.71.3 The stores computer system lacks the provision of an "on order" program facility suitable for recording details of orders placed but not delivered. As a result, separate records of orders need to be maintained to assist in re-order decisions.

2.71.4 The requirement to maintain separate records is considered by audit to be an inefficient use of computer facilities and could result in duplication of orders, as the computer reports will continually identify items below re-order level until orders are filled.

2.71.5 Recommendations

In relation to inventory re-order procedures audit recommends that:

- (1) re-order reviews for paper stocks be carried out on a more frequent and regular basis; and
- (2) urgent action be taken to provide an "on order" program facility in the stores computer system.

2.71.6 Office Reply

Under existing systems, more frequent reviews than monthly are impractical. However, approval has been obtained to implement a purchasing package complementary to the Stores Inventory System. This will enable an effective "Stores Inventory and Re-Order Report" as it will incorporate an "on order" facility, thus enabling more frequent review of selected stock levels.

2.72 Slow Moving and Obsolete Stock

Observation

Procedures for the identification and review of slow moving and obsolete stocks are inadequate and have contributed to significant amounts of surplus and obsolete stocks being held in the Office's inventory.

2.72.1 Publication sales in 1982-83 amounted to \$1.87 million which represented an inventory turnover ratio of 1.64 times per annum. This ratio, low by any standards, indicated that the publications inventory contained a large number of slow moving/obsolete items. Examples included:

Item	Selling Price \$	Qty on Hand 30.6.83	Sales 1982-83	Estim. Supply Held (years)	Value 30.6.83 At Cost \$
Victoria with Love	11.95	12 533	327	38	63 918
W.M. Strutt - Prints	50.00	2 459	139	17	18 422
Victoria the Golden	59.95	1 008	199	5	17 640
Act 6839	9.60	1 865	34	54	8 952
Stat. Rules 342/73	1.70	3 480	72	48	2 958

2.72.2 In audit opinion, the incidence of this overstocking is related to the following factors:

- (1) Regular control reports suitable for the identification and review of slow moving stock items are not produced for the use of stores administration personnel.

Stock records for publications are maintained manually and facilities do not exist for the regular production of reports on slow moving items. For paper and stationery stock an EDP report is produced which lists the date of last movement of individual items. While this report is of some assistance in identifying slow moving items it does not highlight movements in relation to stock levels, i.e. turnover ratios on certain items may be exceedingly low.

- (2) Insufficient attention is given to sales demand for certain publications when production quantities are requested.

Most publications printed and held for resale by the Government Printing Office relate to requests received from client departments and authorities. Initial production run quantities are determined on the basis of expected demand for a publication and the need for minimum runs sufficient to maintain margins.

The Government Printing Office generally assists clients with sales forecasts, but in certain circumstances is totally reliant upon demand estimates provided. In the event of sales forecasts not being met, the Office is left with surplus stocks for which it must bear the eventual costs of write-off and disposal.

A recent example occurred when the Department of Minerals and Energy requested a consolidated reprint of the Mines Act 1958. This request rendered as obsolete stocks of the Mines (Amendment) Act 1983 produced the previous year. The cost of writing off these stocks valued at \$20 000 was borne by the Government Printing Office.

2.72.3 Recommendations

- (1) There is a need for closer monitoring and investigation of slow moving and inactive items in order to achieve more timely identification of possible surplus and obsolete stock holdings.
- (2) Consideration should be given to the extent to which the Government Printing Office must bear the costs of holding surplus and obsolete publications stocks where client decisions have been primarily responsible for the level of holdings maintained.

In these circumstances partial or full charging of inventory costs to the client may be appropriate as an inducement to more accurate sales forecasts in the future.

2.72.4 Office Reply

All obsolete publications stocks are disposed of by Board of Survey action in the year of obsolescence.

Slow-moving and inactive publications stock items have only been disposed of when it can clearly be established that they are no longer of any value. More attention will be given to this aspect of stores management. Many of the legislative-type surplus stocks are a legacy of old technologies, when it was not prudent to regularly produce small runs of these publications. It would assist VGPO if, when client decisions are made to reprint or consolidate legislation, VGPO were reimbursed for losses on stocks thus made obsolete (e.g. Mines (Amendment) Act 1983).

Of the slow-moving stock listed in para. 2.72.1, it is expected that W.M. Strutt prints and Victoria the Golden will be substantially sold in 1984 as part of a promotional campaign for the sesquicentenary year.

2.73 **Storehouse Locations**

Observation

The location of the bulk warehouse store at Maribyrnong is unsuitable in relation to the location of the Government Printing Office's printing works in North Melbourne.

2.73.1 The Maribyrnong bulk store, which houses bulk stocks of paper, stationery and publications, is considered by audit to be poorly located, being some 7 kilometres from the Office's printing works in North Melbourne.

2.73.2 Apart from the costs associated with regular road transport deliveries, this location has resulted in additional expense being incurred in the maintaining of significant working stocks of paper at North Melbourne.

2.73.3 Recommendation

There is a need for an analysis to be made of the costs/benefits of possible alternative locations nearby to the Office's printing works.

2.73.4 Office Reply

The matter of location of bulk store facilities away from North Melbourne has been the subject of prior criticism and is still under review.

2.74 **Stockchecking Frequencies**

Observation

Existing stockchecking frequencies are inadequate.

2.74.1 Apart from some selective checks on certain high turnover items, stockchecks at all stores are generally undertaken only annually. This is despite the high incidence of discrepancies found as a result of previous annual counts and the subsequent difficulties in identifying reasons for their occurrence, especially when the discrepancies may relate back a number of months.

2.74.2 The high incidence of stockchecking discrepancies and the present level of inaccuracy of stock records (refer para. 2.70) indicate that existing counts are neither timely nor cost effective.

2.74.3 Recommendation

The introduction of interim counts, and in particular the weighting of items according to such criteria as item value, turnover, and nature when programming counting schedules, would improve the cost effectiveness of stocktaking procedures.

2.74.4 Office Reply

Selective stock checks are undertaken more frequently than annually, particularly on high turnover items, by the Stock Controller. Administrative arrangements include independent checks by production control officers during the year. Programmed stock-counts will be formalised.

2.75 Stores Performance Evaluation Measures

Observation

The Office has not developed criteria suitable for the evaluation of the operations of its stores function.

2.75.1 To effectively assist management in the monitoring and evaluation of the efficiency of stores operations, performance benchmarks or objectives should be established.

2.75.2 Measures to assist in the evaluation could include analyses of turnover ratios, costs per transaction, transactions per employee, incidence of out of stock situations, and comparisons with similar operations in other States.

2.75.3 Recommendation

Performance measures suitable for the effective monitoring and evaluation of the Office's stores function should be implemented and subsequently produced and reviewed on a regular basis.

2.75.4 Office Reply

Measures have been developed but have not been implemented because additional software for the existing NCR system would have been required and this fell outside of the scope of the original approvals for rental of the NCR system.

Ability to produce effective performance measurements will be facilitated when the present EDP system is upgraded.

Performance measurements of various functions of the Office are required for program budgeting purposes and for cost-effectiveness purposes. It is proposed to do a cost effectiveness analysis of current stores operations measured against the cost of purchasing requirements from paper merchants on shorter lead times at higher unit costs.

PUBLIC WORKS DEPARTMENT

OVERVIEW OF STORES OPERATIONS, POLICIES AND PROCEDURES

2.76 The Public Works Department's supply branch is responsible for the purchase and control of stores within the Department, and for the procurement, custody and distribution of furniture and equipment on behalf of other government departments, mainly Education.

2.77 Inventory value at 30 June 1983 was \$1.41 million; approximately 75 per cent of this total related to furniture.

2.78 Approximately 95 per cent of inventory is held at the Department's major storeyard at Port Melbourne, with the remainder being retained at small locations including the State Vehicle Centre, Fitzroy.

2.79 The supply branch employed 108 staff during 1982-83 and total expenditure on salaries and wages amounted to \$1.86 million.

SUMMARY OF MAJOR AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.80 The major audit observations and recommendations arising from the review were:

- (1) Computerisation of the existing manual stores recording system would result in significant savings in terms of effective use of manpower and reduction of operating costs. In addition, EDP reporting applications would considerably enhance management information essential to the effective monitoring of stores operations.

Audit recommends that action be taken to develop and purchase an EDP stores system incorporating reporting applications suitable for stores management requirements.

- (2) The Port Melbourne storeyard is in urgent need of redevelopment, due to a poor state of repair, inadequate security, and inefficient use of storage facilities.

Audit recommends that high priority be given to upgrading storage facilities, including a rationalisation of the number of storehouses required.

AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.81 Computerisation of Stores Accounting System

Observations

- (1) Computerisation of the existing stores system, which is basically a manual operation, would result in significant savings in terms of effective use of manpower and reducing operating costs.
- (2) Management information essential to the effective monitoring of stores operations would be considerably enhanced with EDP reporting applications.

2.81.1 The existing stores accounting system is labour intensive and costly to operate due to the necessity to manually record numerous transactions. In addition, the system does not have the capacity to produce on a timely basis reports for management on such matters as:

- (1) identification of slow moving/obsolete stocks;
- (2) outstanding purchase orders; and
- (3) stock levels at which re-ordering is necessary.

2.81.2 Certain essential information is produced, but on an irregular basis due to the time required to manually extract information from some 1 400 ledger cards. Failure to have these reports produced regularly limits their value, particularly in regard to prompt corrective action, and contributes to overstocking and out of stock situations.

2.81.3 The supply branch attempts to evaluate stores operations in terms of efficiency and effectiveness by having reports produced, usually annually, on the cost of operations, sectional stock turnovers, stocktake discrepancies and the value of non-moving stocks.

2.81.4 While useful, these measures alone are not sufficient for the effective monitoring of stores operations due to:

- (1) the infrequent intervals at which the reports are produced;
- (2) performance comparisons relating only to the previous year's results and not to benchmark objectives formally established by management; and
- (3) the fact that not all aspects of stores operations are covered.

2.81.5 Additional management information should include reports on turnover of individual items, costs per transaction, incidence of "out-of-stock" situations, seasonal trends, etc.

2.81.6 Audit recognised that the production of additional management information under the present system would involve considerable manual effort. In audit opinion the development of an EDP system incorporating the reporting applications referred to would reduce operating costs, and result in a more effective stores system by providing management with the means by which they can effectively monitor the efficiency and effectiveness of stores operations.

2.81.7 Recommendations

Action should be taken by the Department to develop and purchase an EDP stores system incorporating reporting applications suitable for stores management requirements.

The Department should also develop formal benchmark objectives by which stores performance can be measured.

2.81.8 Departmental Reply

The inadequacy of the management information system is recognised as being an area in which some form of EDP could provide more timely and relevant information without undue manual efforts. This requirement has a high priority and development will proceed when funds are made available.

2.82 **Storage Facilities - Port Melbourne Storeyard**

Observation

Port Melbourne storage facilities are in urgent need of redevelopment due to a poor state of repair, inadequate security and inefficient use of storage facilities.

2.82.1 The Port Melbourne storeyard consists of a collection of storehouses of varying dimensions with the majority being in a poor state of repair. An SEC transmission line easement passes through the site and has contributed to a reluctance to spend money on buildings that may need to be re-located.

2.82.2 The poor state of repair in conjunction with the absence of SEC lighting in some storehouses creates security problems and could lead to items being damaged. This is particularly significant in view of the valuable holdings e.g. electronic equipment held on behalf of the Education Department.

2.82.3 Inefficiencies exist in the utilisation of storage space in that items are housed in a variety of storehouses. Economies could be achieved from the rationalisation of these storehouses into a single complex with modern storage facilities and techniques.

2.82.4 Recommendation

High priority should be given by the Department to obtaining funds to upgrade the Port Melbourne storage facilities, including a rationalisation of the number of storehouses required.

2.82.5 Departmental Reply

The recommendation concerning the state of the storage facilities is endorsed and re-development of the Port Melbourne storeyard has been awaiting allocation of funds to proceed for some years.

2.83 **Stocktaking Procedures**

Observation

Existing stocktaking procedures are not cost effective.

2.83.1 The supply branch employs a full time stocktaking officer, assisted by casual staff, to conduct stock counts on a cyclical basis. All items held in store are counted at least annually with periodic counts being conducted of tools and equipment held by up to 250 operational staff. Significant administrative costs are incurred in resolving and/or adjusting stocktaking discrepancies, of which the final result in 1982-83 was a surplus of \$982.

2.83.2 In audit opinion the cost effectiveness of conducting stock counts in the above manner is doubtful.

2.83.3 Recommendation

Consideration should be given to introducing programmed interim stock counts according to criteria such as nature of item and value, turnover, and existing security.

OFFICE OF THE CHIEF COMMISSIONER OF POLICE

OVERVIEW OF STORES OPERATIONS, POLICIES AND PROCEDURES

2.84 The supply branch of the Office of the Chief Commissioner of Police has 2 distinct sections:

- (1) the administration and direct purchasing sections located at Police Headquarters, William Street; and
- (2) the general store at Collingwood, which is primarily responsible for the supply of uniforms and other requisites essential to the police in the performance of their public duties. Also at this location there are 2 smaller stores holding spare parts and equipment relating to the police vehicle fleet and radio and electronic operations.

2.85 Total inventory value at 30 June 1983 was \$1.9 million. During that year the supply branch employed 47 personnel and payroll costs were approximately \$758 000.

SUMMARY OF MAJOR AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.86 The major audit observations and recommendations arising from the review were:

- (1) The general store holds significant levels of potentially surplus and obsolete inventory.

Audit recommends that consideration be given to changing the method of funding to put the operation on a more commercial basis. In addition, a reporting function should be developed which will identify slow moving/obsolete stocks.

- (2) Duplication of purchasing functions and staffing inefficiencies exist in that a large number of items purchased by the direct purchasing section could be supplied from the general store.

Audit recommends that a survey be undertaken of direct purchases to determine what items could be more efficiently supplied through the store, and to take appropriate action to implement a change in supply procedures.

AUDIT OBSERVATIONS AND RECOMMENDATIONS

2.87 Excess Stock Holdings

Observations

- (1) Procedures do not exist for the regular review of inventory levels in order to identify slow moving/obsolete items. This has contributed to significant amounts of potentially surplus and obsolete inventory being held in the general store.
- (2) There are a number of items in the store that have become overstocked or redundant due to changes in police policy.

2.87.1 During the year ended 30 June 1983, issues from the general store were valued at approximately \$2.29 million. When compared with purchases for the year of \$2.1 million, this represented a very low stock turnover rate of 1.38 times per year.

2.87.2 Factors contributing to the low turnover rate were:

- (1) Present procedures for the identification of slow moving and potentially obsolete items are inadequate.

A review of inventory items in the general store disclosed that over 2 years' supply (estimated value \$765 494, 30 June 1983) existed for approximately 46 per cent of items held. Examples included:

<u>Item</u>	<u>Quantity on Hand 16 Dec. 1983</u>	<u>Value \$</u>	<u>Average Yearly Issues</u>	<u>Estimated Years to use Current Stock</u>
Binder	18 396	36 792	2 110	9
Cape Waterproof Size 5	506	39 974	54	9
Peerless Handcuffs	954	17 649	4	238
Overcoat Gabardine Old Style	275	22 000	10	27
Overcoat Gabardine Jog	289	28 611	None	?

Reports produced by the computer do not highlight slow moving items and the only time inventory is reviewed is when an item comes up for re-order.

- (2) Inadequate liaison between the Police Advisory Group and stores management.

The Department has an Advisory Group whose role is to advise stores management of any contemplated changes in departmental policy which are likely to affect stores items. However, there have not been regular meetings between this group and stores management, resulting in decisions being made which have adversely affected stockholdings.

For example, the binders valued at \$36 792 referred to in para. 2.87.2 (1) are used to retain Acts of Parliament, copies of which were formerly issued to every police officer in Victoria. In 1983 the Advisory Group decided it was sufficient that issues be restricted to one set per police station. This decision was not communicated to stores personnel and a further 10 000 binders were purchased in the year. The reduction in usage has resulted in current stocks representing approximately 60 years supply.

(3) Method of funding stores operations.

Stores operations are funded by an appropriation from the Consolidated Fund. The annual amount to be appropriated is based on a budget prepared by the supply branch which takes into account the previous 2 years' expenditure on stores purchases. However, consideration is not given in the budget to the value of inventory on hand in the general store and at police stations or the level of issues during the period.

Expenditure figures may also be distorted by orders being placed for items with a high stock level purely to ensure that an annual appropriation is fully expended. Failure to spend an annual appropriation could result in a reduction in funds the following year.

2.87.3 Recommendations

Audit recommendations were:

- (1) A computer report should be developed for management to highlight stock items for which over 2 years' supply exists and items that have not been issued in the last 6 months.
- (2) The Police Advisory Group should meet regularly with stores management to advise of changes in departmental policy and to make recommendations concerning utilisation of inventory items affected by such decisions.
- (3) The funding of stores should be changed to a "Suspense Account" system similar to that operated by the Education and Public Works Departments. Under this system issues, in effect, create "credits" which can be used to purchase stores. The level of purchasing is therefore tied to issues rather than to a total yearly budget which can lead to overstocking.

2.87.4**Office Reply**

- (1) The Office advised that with the introduction of the new computer-based inventory system it is expected that the increased frequency of reporting obtained from the system will enable a more concerted effort to be made to reduce the level of surplus and obsolete inventory items being carried in the stores.
- (2) It has been noted that there are occasions when the communication between the Advisory Group and stores personnel breaks down, causing problems of overstocking. The procedures for notifying the supply branch and, in turn, the stores area will be further examined.
- (3) The Office proposes to seek approval to study the operation of the stores area of the Education Department.

2.88**Direct Purchasing****Observations**

- (1) Approximately 20 per cent of purchases handled by the direct purchasing section are items that could be handled by the store. This results in duplication of purchasing functions and consequent inefficient use of manpower.
- (2) A lack of forward estimates of requirements means that savings cannot be achieved through discounts from bulk buying.

2.88.1 The direct purchasing section operates separately from the stores function and is responsible for supplying direct to various other sections such items as stationery, photographic material, detergent etc., as well as certain capital equipment, e.g. radar guns.

2.88.2 Due to the present manual accounting system the extent of such purchases could not be established. However, in audit opinion, a large percentage of the purchases are items common to a number of sections that could be handled more efficiently through the Department's stores operations. Advantages include:

- (1) price discounts through bulk purchasing;
- (2) elimination of delivery delays through having stocks on hand; and
- (3) more efficient use of manpower and Office resources by avoiding duplication of purchasing functions.

2.88.3 Recommendation

A survey should be undertaken of direct purchases to determine what items could be more efficiently supplied through the store.

2.88.4 Office Reply

The Office has indicated that a review is to be carried out of the supply branch's direct purchasing operation with a view to reducing the number of such orders placed.

2.89 **Monitoring of Stores Usage at Police Stations**

Observation

There is little overall monitoring of the value of stores used by the individual police stations, with the result that inefficient use of stores is not highlighted.

2.89.1 The general store supplies police stations throughout Victoria with a wide range of items such as stationery, torches, handcuffs, uniforms etc. Stores requisitions are approved at divisional headquarters, but there is no attempt to cost the issues or to monitor usage at individual stations.

2.89.2 Audit is of the opinion that stations should be made aware of the value of stores requisitioned and there should be greater accountability for their use. By way of example, audit established that during 1982 Geelong Police Station, with 102 personnel, requisitioned stores to the value of \$3 256. During the same period Ballarat Police Station, with only 57 personnel, obtained stores to the value of \$3 104. Reasons for the variance were not established and information relating to direct purchasing by these stations was not available.

2.89.3 Recommendation

The new computer system has the facility to cost requisitions on a station basis. Audit recommends that this report be used by divisional headquarters or police inspectors to monitor stores usage by individual stations. Consideration should also be given to entering prices on materials issued vouchers in order to create an awareness in police stations of the need for efficient use of the items.

2.89.4 Office Reply

The Office agrees with the recommendations and the possibility of having the prices of items printed by the computer on issue vouchers is being investigated.

2.90 Performance Evaluation Measures

Observation

Stores performance evaluation criteria have not been developed for management to assist in monitoring the performance of the stores operation and to determine whether services are being provided in an economic and efficient manner.

2.90.1 Audit considers that performance evaluation criteria, including performance benchmarks, should be developed by the supply branch to assist management in the monitoring and evaluation of the efficiency of stores operations.

2.90.2 Measures that should be developed could include analyses of turnover ratios, costs per transaction, incidence of out-of-stock situations and transactions per employee.

2.90.3 With effective performance evaluation measures problem areas can be highlighted at an early stage, allowing preventative action to be instigated immediately.

2.90.4 Recommendation

Performance evaluation criteria, including suitable performance benchmarks, should be established and subsequently produced and reviewed by management on a regular basis.

2.90.5 Office Reply

The Office considers that inadequate staffing levels at the store make the introduction of performance evaluation measures difficult.

The matter of staffing levels is currently under review in connection with the preparation of staffing estimates for the financial year 1984-85.

SCHEDULE
STORES ON HAND AT 30 JUNE 1983

<u>Statutory Authorities</u>	<u>Stores on Hand \$000</u>	<u>Issues 1982-83 \$000</u>	<u>Turnover Rate</u>
Country Fire Authority	1 717
Country Roads Board	3 897	18 309	4.69
Gas and Fuel Corporation of Victoria	22 700	88 500	3.90
Grain Elevators Board	1 011	1 353	1.34
Housing Commission	820	1 831	2.23
Melbourne and Metropolitan Board of Works	17 131	45 333	2.65
Melbourne and Metropolitan Tramways Board	2 800	8 302	2.97
Metropolitan Fire Brigades Board	1 375	3 032	2.21
Port of Melbourne Authority	3 151	6 600	2.10
State Electricity Commission of Victoria	90 599	154 009	1.70
Transport Regulation Board	552
Victorian Railways Board	12 600	76 000	6.03
	<hr/> 158 353	<hr/> 403 269	
 <u>Government Departments</u>			
Department of Agriculture	1 483
Department of Community Welfare Services	1 473
Department of Crown Lands and Survey	2 123	4 029	1.09
Education Department	2 100	7 200	3.43
Forests Commission	521	3 729	7.16
Health Commission of Victoria	2 404	10 000	4.16
Department of Minerals and Energy	2 094	460	..
Ministry of Police and Emergency Services - Office of the Chief Commissioner of Police	1 900	4 193	2.21
Department of Property and Services - Government Printing Office	3 368	9 023	2.68
Public Works Department	1 414	6 500	4.60
Ministry of Water Resources and Water Supply	1 228	3 693	3.01
	<hr/> 20 108	<hr/> 48 827	

FOOTNOTE This table is based on information supplied by the various departments and statutory authorities and is a listing where holdings exceed \$500 000. Information relating to turnover was not available from:

- Department of Agriculture
- Department of Community Welfare Services
- Country Fire Authority
- Department of Minerals and Energy
- Transport Regulation Board

3. Review of Departmental Cash Management

RECEIPTS AND PAYMENTS OF THE PUBLIC ACCOUNT

3.1 The overall Consolidated Fund receipts of the State in 1983-84 were \$7 859 million.

3.2 These collections are received by various revenue collectors who either bank the collections directly into the Public Account (Receivers of Revenue) or remit the collections to the Department of Management and Budget as specified by the Treasurer, usually on a daily, weekly, fortnightly or monthly basis (Collectors of Imposts). The latter collections are initially deposited in departmental revenue accounts and subsequently deposited in the Public Account. These differing procedures date back to the Gold Rush days of the mid-nineteenth century but the trend over recent years has been to appoint new revenue collectors as Collectors of Imposts rather than Receivers of Revenue.

3.3 The Public Account is the Treasurer's bank account and is spread over 3 of the private banks and the State Bank. The State Bank processes the majority of the transactions. The principle of sharing the Public Account between the banks originates from a formal agreement negotiated in 1903.

3.4 The majority of payments are made direct from the Public Account by the Department of Management and Budget and charged against departmental appropriations. However, the Public Account Act 1958 also provides for the use of the Public Account for temporary advances for a number of purposes related to the needs of government and a number of large departments make all their payments through their advance accounts. Other departments use advance accounts to settle urgent claims. The advance accounts are maintained outside the Public Account.

3.5 During 1982 the Department of Management and Budget established the Victorian Development Fund with the overall objective of improving the efficiency of the public sector's cash and investment management, both short and long term. The Fund also provides a short and long term source of borrowing for the Public Account is an avenue for investing any surplus funds of the Public Account. It is the Department's policy to use the Fund for all short term borrowings by the Public Account and investments of the Public Account.

3.6 Although the operations of the Victorian Development Fund are not part of this report, it has been identified by the Department as an important initiative in the overall management of the cash resources of the public sector.

3.7 In addition to departmental advance accounts, the Department of Management and Budget operates the Government of Victoria Drawings Accounts which are used to meet the salary payments of a number of departments. The Drawings Accounts are also maintained outside the Public Account.

3.8 In addition, various trust moneys are held outside the Public Account and administered directly by individual departments. For example, the Law Department administers substantial trust moneys relating to various court decisions.

ROLE OF DEPARTMENT OF MANAGEMENT AND BUDGET

3.9 The Department of Management and Budget has as one of its functions the overall responsibility for the cash management of the State. Prior to its creation by Order-in-Council of 12 October 1982, this role was carried out by the former Treasury Department. The new Department became formally operational on 14 February 1983.

3.10 The objectives of the Department of Management and Budget in relation to cash management are as follows:

- (1) to provide a focus for the development of improved approaches to financial management throughout public administration in Victoria;
- (2) to maintain the liquidity of overall government operations, to monitor detailed cash flows throughout the year, and to advise government of any necessary action;
- (3) to manage centralised government investments in accordance with overall government policies and priorities; and
- (4) to advise on and, where necessary, manage the financial assets of both departments and public authorities so as to protect the interests of, and maximise the return to, the State.

3.11 The Department's organisational structure consists of 6 divisions including the Division of Finance and Investment Policy and Management and the Division of Comptroller-General.

3.12 The Division of Finance and Investment Policy and Management is responsible for longer term policies for cash and investment management. The Comptroller-General's Division is responsible for the day to day management of the Public Account. Within the Division this responsibility is exercised by the Cash Control Section. Of the 12 officers in both divisions involved in cash management operations at the date of the review, only one senior officer was involved in monitoring and analysis.

TERMS OF REFERENCE OF REVIEW GROUP

3.13 On 1 December 1983 I informed the permanent heads of a number of departments of the establishment of an audit review group to examine the procedures in operation for departmental cash management.

3.14 This audit review group had the following terms of reference:

- * To determine the adequacy of the current procedures for the management of public account cash resources and whether the optimum return is being achieved on such resources.
- * In particular the review was to include:
 - (1) procedures in operation to ensure that public moneys are deposited in the Public Account at the earliest possible date;
 - (2) procedures established to ensure that a proper return is obtained from public account cash resources; and
 - (3) whether alternative methods for the handling of public account cash resources have been considered by management and if so with what result.

SCOPE AND CONDUCT OF THE REVIEW

3.15 The review covered the period 1 July 1983 to 30 November 1983 and, whilst covering 4 departments, concentrated on the role played by the Department of Management and Budget in the cash management of the Public Account. The review commenced on 1 December 1983 and concluded on 15 February 1984.

3.16 The following 3 other organisations were selected to ensure a representative overview of the cash management procedures of the government departments:

- (1) Law Department
- (2) Divisions of Forests and Lands of the Department of Conservation, Forests and Lands
- (3) State Rivers and Water Supply Commission.

3.17 Interviews were conducted with senior officers to obtain initial information, after which reports, files and other documents were examined in sufficient detail in order to meet the objectives of the review contained in the terms of reference.

SUMMARY OF MAJOR AUDIT OBSERVATIONS AND RECOMMENDATIONS

Observations

3.18 Departmental cash resources have not been adequately managed over a number of years to maximise the net return to the State.

- (1) At the date of the review the rate of interest earned on the Public Account was only 4 per cent and had not been changed since 1974. Audit estimates that if the rate of interest had been tied to the short-term bond rate an additional \$218 000 would have been earned in the 5 months period (\$523 000 for a full year). (Subsequent to the completion of the review an increase in the rate has been negotiated with the banks).
- (2) There were inadequate monitoring mechanisms within the Department of Management and Budget to ensure that with the low rate of interest being earned, the balances in the Public Account, Advance Accounts and Drawings Accounts were kept to a minimum and surplus moneys were invested elsewhere at a higher rate of return.
- (3) On 31 March 1983 the Treasurer authorised the Department of Management and Budget to investigate current banking arrangements and alternative cash forecasting systems but at the date of the review no significant action had been taken by the Department to investigate these matters.
- (4) No quantifiable performance measures had been developed by the Department of Management and Budget to evaluate the effectiveness of the cash management system.
- (5) Only one of the 280 departmental revenue accounts subject to the review earned interest. Consequently, interest of approximately \$64 000 was lost to the State during the 5 months covered by the review (\$153 000 for a full year) as a result of collections not being banked directly or promptly into the Public Account.
- (6) Unnecessary balances were being maintained in departmental advance accounts. Although the 5 major advance accounts covered by the review earned interest, the remaining 206 advance accounts reviewed did not. This resulted in a cost to the State of approximately \$52 000 during the 5 months covered by the review (\$124 800 for a full year).
- (7) Interdepartmental transactions are generally settled by cheque. This is an inefficient use of cash resources which can lead to losses of interest to the State.

Recommendations

3.19 Audit recommended that the Department of Management and Budget should review the current cash management procedures operating within the government departments and in particular:

- (1) enter into negotiations with the banks with a view to obtaining the best possible net return on the State's banking business;
- (2) take action on the authority given by the Treasurer on 31 March 1983 to investigate the current banking arrangements and alternative cash forecasting systems so as to minimise the holding of cash balances in the Public Account;
- (3) develop performance indicators that will enable the Department to monitor the extent to which the best possible net return is being obtained;
- (4) immediately review the present remittance procedures for all Collectors of Imposts with a view to improving the cash flow to the Public Account;
- (5) give high priority to implementing a central cash management system which will remove the need for advance accounts. In addition, the Department as an interim measure should:
 - (i) negotiate with the banks with a view to obtaining interest on all advance accounts; and
 - (ii) set clear objectives in relation to the funding of advance accounts to ensure that balances are kept to a minimum; and
- (6) review the current practice of settling interdepartmental transactions by cheques.

AUDIT OBSERVATIONS AND RECOMMENDATIONS

3.20 Interest on the Public Account

Observation

At the date of the review the rate of interest on the Public Account was only 4 per cent and had not been adjusted since 1974.

3.20.1 This rate, which had not been formally reviewed by the Department since 1 July 1974, was also the rate charged by the banks on any temporary overdraw of the Public Account. The interest earned on the Public Account for the 5 months period covered by the review was approximately \$238 000.

3.20.2 In discussions with senior management of the Department of Management and Budget in December 1983, audit was advised that the Department considered this rate to be reasonable considering that no bank charges, other than overdraft charges, were payable. However, no calculations of the costs and benefits of the arrangements, taking account of other bank charges that would otherwise have been payable, had been made to support this view. The Department was not permitted to overdraw the bank accounts on a continuous basis and the overdraft rates applied only to accidental overdraw. Total charges of approximately \$2 500 were incurred on the 6 occasions the account was accidentally overdrawn during the period.

3.20.3 In audit opinion the rate of 4 per cent could not have been considered reasonable due to the the upward trend in other interest rates since 1974 (refer Schedule below). If the interest rate earned on the Public Account since 1974 had moved in line with the short-term bond rate, an additional \$218 000 would have been earned in the 5 months period.

SCHEDULE

Interest on Public Account Current Account

<u>Public Account Rate %</u>	<u>Short-term Bond Rate %</u>	<u>Date</u>
1.875	4.0	1. 7.1959
2.25	6.4	1. 1.1971
4.00	8.0	1. 7.1974
4.00	9.0	1. 7.1975
4.00	9.2	1. 7.1976
4.00	10.0	1. 7.1977
4.00	9.0	1. 7.1978
4.00	9.25	1. 7.1979
4.00	9.75	1. 7.1980
4.00	12.25	1. 7.1981
4.00	13.25	1. 7.1982
4.00	12.25	1. 7.1983

3.20.4 Recommendation

Audit recommended that the Department of Management and Budget enter into negotiations with the banks with a view to obtaining the best possible net return on the State's banking business.

3.21 **Monitoring Mechanisms to Minimise Balances**

Observation

Adequate monitoring mechanisms did not exist within the Department of Management and Budget to ensure that with the lower rate of interest being earned than could be earned in other forms of deposit (e.g. Cash Management Account) the balances in the Public Account and Drawings Accounts were kept to a minimum.

3.21.1 Public Account Balances

A mechanism to monitor the cash flows of the Public Account has existed for a number of years. This mechanism was as follows:

Prior to 10.30 a.m. on each working day, a senior officer of the Department set out a working sheet which recorded the following:

- (1) the bank and cash book balances and the outstanding short-term borrowings or investments from the Victorian Development Fund at the end of the previous day;

- (2) the anticipated expenditure for the day; and
- (3) the anticipated revenue for the day. Estimated bankings for the day by major Receivers of Revenue were obtained directly from these Receivers of Revenue. Estimates of other bankings were made, based on previous experience.

From this information the Department considered that the senior officer was in a position to estimate the amount that the cash book could be overdrawn without actually overdrawing the bank balances. This was based on past presentation patterns, certain rules of thumb and his or her own personal experience.

To determine whether the above procedures ensured a satisfactory return to the State audit examined the daily cash balances of the Public Account for the period.

It was noted that:

- (i) on one day only in the 5 months period was the consolidated Public Account bank balance overdrawn;
- (ii) the consolidated Public Account bank balance fell below \$4 million on 6 occasions only;
- (iii) on 123 occasions the consolidated Public Account bank balance was greater than \$6 million; and
- (iv) the average daily balance was \$17.7 million.

Notwithstanding the fact that the average daily bankings and payments from the Public Account during the period were approximately \$53 million per day, audit considers that it is unsatisfactory to have an average daily balance in the Public Account in excess of \$17 million.

3.21.2 Drawings Accounts

The payment of salaries and wages for the majority of departmental employees is made from 2 accounts maintained with the State Bank. These accounts, titled Government of Victoria Drawings Accounts Nos. 1 and 2 earn interest at the rate of 4 per cent.

The No. 1 Account is used to pay public servants who are paid through the government payroll system (Paycost) whilst the No. 2 Account is used to pay Police Department salaries. Both accounts are funded by transfers from the Public Account. Each fortnight approximately \$17.3 million and \$9.2 million are transacted through the respective accounts.

The Department of Management and Budget staggers the deposits to these accounts during the pay period, based on estimated presentation patterns for cheques drawn on the accounts, to avoid excessively high balances being maintained in the accounts. Audit examined the balances of the 2 accounts for the first 6 days after each pay day during the period under review and it was noted that excessive balances were being retained, especially over the weekend.

In the No. 1 Account:

- (1) on 8 out of the 11 pay days examined the balance was greater than \$1.6 million over the weekend; and
- (2) on the fifth day after each pay day the balance was not less than \$700 000.

This problem did not exist to the same extent in the No. 2 account. Except on one occasion when the account was overdrawn by \$1.9 million, the balance held over the weekend averaged \$501 000.

3.21.3 General Comments on Procedures and Balances

It should be noted that the Public Account and Drawings Accounts balances include amounts borrowed from the Victorian Development Fund on which interest is charged as on all but 16 occasions during the period the Public Account held insufficient funds without these borrowings to meet its short term commitments.

In audit opinion the above procedures are unsophisticated when compared with a number of financial forecasting packages presently available.

The cost to the State of maintaining a credit balance in the Public Account and Drawings Accounts through the borrowing from the Victorian Development Fund was approximately \$558 000 for the 5 months period (\$1 339 000 for a full year). These calculations were based on the difference between the cost of borrowing which averaged approximately 12 per cent for the period and the 4 per cent interest paid on the credit balances of the Public Account and Drawings Accounts.

The problems related to banking arrangements and the lack of sophistication in the monitoring system have been recognised by the Department and on 31 March 1983 the Treasurer authorised:

- (1) a review of the banking arrangements with a view to achieving efficiency through rationalisation; and
- (2) the Department to investigate the feasibility of utilising the services of Bank Link, which it is claimed can provide information each morning on the position of each of the accounts subject to its control. It is further considered that if Bank Link was combined with a suitable computer package, it could provide improved cash management.

However, at the date of the review the Department had not taken any significant action on the authorisations.

3.21.4 Recommendations

Audit recommended that the Department of Management and Budget take action on the authority given by the Treasurer on 31 March 1983 to investigate the current banking arrangements and alternative cash forecasting systems so as to minimise the holding of cash balances in the Public Account and Drawings Accounts.

3.22 Cash Management Performance Indicators

Observation

No quantifiable objectives had been developed by the Department at the date of the review against which the effectiveness of the cash management system could be evaluated.

3.22.1 The Comptroller-General's Division of the Department has as one of its stated objectives "to minimise the cost of short term finance or maximise the return from investments by providing up-to-date information on the cash position of the Public Account".

3.22.2 However, the Division uses no quantifiable performance measures nor any bench marks such as industry standards to judge whether or not this objective is being met.

3.22.3 Recommendation

Audit recommended that the Department of Management and Budget develop objectives for its cash management operations that will enable it to monitor the extent to which the best possible return is being obtained.

3.23 Departmental Revenue Collection Procedures

Observation

Of the 280 departmental revenue accounts subject to the review, only one - the State Rivers Head Office Revenue Account - earned interest. Consequently, interest of approximately \$64 000 was lost to the State (\$153 000 for a full year) as a result of collections not being banked directly or promptly into the Public Account.

3.23.1 Many Collectors of Imposts, including Clerks of Courts, appointed under the Audit Act 1958 hold revenue collections in non-interest bearing bank accounts prior to remitting their collections to the Department of Management and Budget on a predetermined daily, weekly, fortnightly or monthly basis for credit to the Public Account.

3.23.2 During the period of the review collections of approximately \$40 million were received from a number of these revenue collectors. It is estimated that due to the practice of these collectors not remitting their revenue collections to the Department of Management and Budget on a daily basis, interest of approximately \$48 000, calculated at the cost of borrowing, has been lost to the State (\$115 200 in a full year).

3.23.3 As part of the review the revenue collections of the Titles Office and Corporate Affairs Office were examined for the period. It was noted that although both Collectors of Imposts were required by the Treasurer to remit their collections daily to the Department of Management and Budget, collections still remained in non-interest bearing bank accounts throughout the period. Audit estimated that interest of approximately \$16 000, calculated at the cost of borrowing (\$38 400 in a full year), has been lost to the State through the non-appointment of the officers in charge as Receivers of Revenue.

3.23.4 The Comptroller-General's Division of the Department of Management and Budget has not established clear procedures to ensure the timely banking into the Public Account of departmental revenue received by Collectors of Imposts.

3.23.5 In audit opinion the practice of maintaining revenue collections in separate non-interest bearing bank accounts prior to the collections being forwarded to the Department of Management and Budget has led to delays in the revenue being paid into the Public Account and consequently a loss of interest revenue.

3.23.6 Recommendation

It was recommended that the Department of Management and Budget review the remittance requirements of all Collectors of Imposts with a view to improving the cash flow to the Public Account, and that the following options be considered:

- (1) negotiate with the banks to obtain interest on all departmental revenue accounts; and
- (2) provide for the direct deposit of all collections to the Public Account.

3.24 **Management of Departmental Advance Accounts**

Observation

Balances are being maintained in departmental advance accounts. Although the 5 major advance accounts covered by the review earned interest (2 operated by the Forests Division and 3 by the State Rivers and Water Supply Commission) the remaining 206 advance accounts reviewed did not. This resulted in a loss of interest to the State of approximately \$52 000 during the period of the review (\$124 800 for a full year).

3.24.1 Most departments operate one or more advance accounts, which are funded from the Public Account. Departments are required to apply to the Department of Management and Budget for an annual advance sufficient to cover their estimated fortnightly or monthly payments. This advance in effect operates as a cash float within the account. All applications are reviewed by a senior officer of the Department of Management and Budget prior to approval. At 30 November 1983 the total of outstanding advances from the Public Account to departmental advance accounts amounted to \$9 010 753.

3.24.2 The Department of Management and Budget advised that the 5 larger advance accounts (operated by the Education Department, State Rivers and Water Supply Commission, Public Works Department, Forests Division of the Department of Conservation, Forests and Lands and the Health Commission) received interest on the daily balances at the rate of 4 per cent.

3.24.3 Since the date of the review an increase in the rate of interest payable by the banks on 3 of these larger departmental advance accounts has been negotiated.

3.24.4 Audit examination covered only the advance accounts held by the departments included in the review. It was noted that many large balances were held in these accounts. This indicates that existing Department of Management and Budget procedures for determining the amount of advances were in need of review to ensure departments did not hold unnecessary funds. It was estimated by audit that interest of approximately \$52 000 was lost to the State for the 5 months period (\$124 800 in a full year).

3.24.5 The Department had recognised that maintaining advance accounts is an inefficient use of cash resources and was developing a centralised cash management system which would remove the need for advance accounts. However, audit noted that interest is not payable on all advance accounts.

3.24.6 Recommendations

Audit recommended that the Department of Management and Budget give priority to implementing a central cash management system which will remove the need for advance accounts.

In the interim the Department of Management and Budget should:

- (1) negotiate with the banks with a view to obtaining interest on all advance accounts; and
- (2) review its procedures for determining levels of funding of advance accounts to ensure that balances are kept to a minimum.

3.25 **Interdepartmental and Inter-Account Transactions**

Observation

Interdepartmental and inter-account transactions are generally settled by cheque. In audit opinion these procedures constitute an inefficient use of cash resources and have led to losses of interest to the State.

3.25.1 Under the existing procedures moneys are withdrawn from the Public Account and/or advance accounts and subsequently repaid to the Public Account. This practice, which was brought to the Treasurer's attention in an audit report on the Department of Property and Services dated 14 July 1982, results in interest being lost to the State.

3.25.2 Examples of departmental organisations receiving large amounts by way of inter-departmental cheques in the 1982-83 financial year were:

<u>Recipient</u>	<u>Receipts 1982-83</u> \$
Government Printing Office	25 502 449
Government Computing Service	6 028 008

3.25.3 A further example is the current procedure for the payment of deductions from salaries, such as PAYE taxation. The Department of Management and Budget draws a cheque for the total deductions to be made from each department's payroll. These cheques are paid to the departments and deposited in the respective departmental advance accounts. Taxation deductions by the respective departments are repaid to the Department of Management and Budget for credit to the Payroll Deductions Suspense Account pending payment to the Australian Taxation Office at the end of each month. In 1983-84 these payments totalled \$705 million.

3.25.4 In audit opinion such procedures result in an inefficient use of cash resources which can lead to losses of interest to the State.

3.25.5 Recommendation

The current practice of settling interdepartmental and inter-account transactions by cheque should be reviewed.

3.26 **Management of Trust Moneys**

Observation

Many departments maintain trust accounts which do not form part of the Public Account and are held for various purposes. The number of such trust accounts and the amount of the balances held was not known by the Department of Management and Budget at the time of the review.

Information on the balances of these accounts will in the future be reported in the annual departmental financial statements prepared under the Annual Reporting (Departments) Regulations 1984.

3.26.1 This review covered only trust accounts maintained by the Law Department which is responsible for administering trust moneys arising from certain court decisions. Apart from Poor Box Accounts (which earned interest at 3.75 per cent) the majority of the trust accounts held at Magistrates' Courts (100 out of 104 accounts) earned no interest. Trust moneys held at the County Court, the Supreme Court and the Melbourne Magistrates' Court either earned interest or were partially deposited in the Public Account.

3.26.2 Over the years, doubts have been expressed as to the legal authority to invest trust funds other than Poor Box Funds. However, the Courts (Powers of Investment) Act 1983, which was proclaimed on 1 January 1984, allows for the investment of such moneys in authorised Trustee Investments and for the interest to be credited to the Consolidated Fund.

3.26.3 Audit was unable to accurately determine the amount of interest lost to the Consolidated Fund. However, to enable an estimate to be made, the month-end balances of trust accounts were obtained. Assuming constant balances throughout the month and interest of 11.75 per cent being earned (the average short term bond rate for the 5 months period) audit estimates the amount of interest lost to the State for the 5 months period as approximately \$72 000 (\$172 800 for a full year).

3.26.4 Recommendations

Audit recommended that:

- (1) the Department of Management and Budget develop guidelines for the management of all trust accounts held outside the Public Account; and
- (2) the Law Department take steps to invest trust account moneys.

RESPONSE BY DEPARTMENTS

DEPARTMENT OF MANAGEMENT AND BUDGET RESPONSE

3.27 **General**

3.27.1 The current situation should be judged in its correct historical perspective. For many years a cash management system, which relies heavily on manual procedures, has been in place. The demands placed on this system are considerable, and when viewed in combination with the changes that have occurred in the financial markets, complex problems are apparent.

3.27.2 Many of the issues referred to were recognised well before the commencement of the audit review. However, appropriate actions which would effect the desired improvement in the State's cash management must at times be temporarily set aside, given other areas of urgent need and available resources. Nevertheless, some major improvements have been achieved.

3.28 Interest on the Public Account

3.28.1 In January this year, the 4 major banks with which the Public Account is held were requested to consider an increase in the interest rate applicable to daily balances on the account and on certain major departmental accounts.

3.28.2 After negotiations with the banks, a significant increase in the rates of interest paid on the daily balances of the Public Account by all participating banks was accepted by the Treasurer. These rates will be regularly reviewed in future.

3.29 Monitoring Mechanisms to Minimise Balances

3.29.1 It is not correct to say that there are no adequate monitoring mechanisms to ensure that balances in the Public Account and Drawings Accounts are kept to a minimum. Specific objectives were established for the Cash Control Section of the Department soon after it was established. Complex but informal mechanisms are in place to monitor progress towards these objectives.

3.29.2 The bank account balances are small when judged against the actual size of the cash flow. Large receipts are often received unexpectedly after the short-term financing decisions are made and the pattern of cheque presentations can never be known in advance. With some cheques regularly exceeding \$55 million each, one day's lack in presentation can easily cause unexpected peaks in bank balances.

3.29.3 There have been considerable negotiations on the implementation of new systems to improve cash management procedures, notably the possible adoption of a computer based information system for bank balances and transactions. The implementation of a computer based system has not proceeded as quickly as had been hoped due to difficulty in obtaining approvals for the necessary staff. Whilst staffing problems still exist within the Department it is expected that an additional 2 staff will be appointed in 1984-85 to aid the Manager, Cash Control Section. Computing facilities will soon be available to assist in the cash budgeting and monitoring processes involved with funding or investing the Public Account.

3.29.4 It is anticipated that these facilities, together with reports from the FM 80 computer software which is currently being developed to replace the FRAR reporting system will also help determine the presentation pattern of various payments from the Public Account.

3.29.5 The cash management packages offered by the banks which are compatible with the Department's computer facilities will be further evaluated and there is every possibility that some or all of these packages will be decided later this year.

3.30 Cash Management Performance Indicators

3.30.1 The specifications of the requirements for the FM80 computer software to replace FRAR are quite explicit that cash management will be further centralised and that facilities should be provided for reporting performance indicators.

3.30.2 Work has commenced on the development of cash management performance indicators. It is anticipated that the initial indicators will be tested in the near future. These will be reviewed and evaluated after a few months' operation and will be amended as necessary. Additional performance indicators will be introduced progressively and subjected to similar review, evaluation and amendment as they are developed.

3.31 Departmental Revenue Collection Procedures

3.31.1 A complete review of the adequacy of collection periods for all Collectors of Imposts has been undertaken. Through the development of a computerised data base and reporting system, information is now available on the daily performance of collectors and any other person receiving revenue.

3.31.2 As a consequence of that review, daily collectors who have been tardy in forwarding their collections to the Department of Management and Budget have been requested to review their procedures with a view to having their collections to the Department by the next working day. Twenty-four departmental collectors were requested to amend their collection periods and a further 7 departmental collectors were requested to remit their collections whenever the balance in their revenue accounts exceeded \$5 000. In addition, the County Court and 30 Magistrates' Courts were requested to amend their collection periods.

3.31.3 So far, the response to these requests has generally been favourable and work in this area is still progressing.

3.31.4 The Treasurer has recently approved the appointment of Receivers of Revenue, who make deposits direct to the Public Account, in lieu of Collectors of Imposts, for the Department of Agriculture and the Law Department. The Treasurer has also approved the amendment of collection periods for 11 departmental collectors, the County Court and 21 Magistrates' Courts. A further submission will shortly be put to the Treasurer recommending the appointment of Receivers of Revenue at 8 of the major Magistrates' Courts where there are presently Collectors of Imposts, and amending the collection periods of 3 more departmental collectors.

3.32 Management of Departmental Advance Accounts

3.32.1 The observation that unnecessary balances are held in departmental advance accounts is a matter of judgment, particularly as interest is currently earned on all substantial advance accounts.

3.32.2 It is proposed to update policy guidelines previously issued by Treasury concerning the expected operation of these accounts. It is also proposed to require departments to review the timing of payments from the Public Account to ensure that they are not made before they are actually required.

3.32.3 Closer attention to the level of balances held in these accounts is expected when cash management packages are introduced. The FM80 computer software chosen to replace the FRAR system provides for centralised techniques for paying departmental expenses and further dramatic improvements are expected when this system is fully operational.

3.33 Interdepartmental and Inter-account Transactions

3.33.1 In order to minimise the cost of the current arrangements the exchange of large cheques is monitored closely to ensure that unnecessary balances are minimised. However, the Department agrees that a system of non-cash settlements may prove equally as effective as the present arrangements and possibly less costly. The Department is actively evaluating the use of computer networks for processing inter-departmental transactions.

LAW DEPARTMENT RESPONSE

3.34 Management of Trust Moneys

3.34.1 A Working Party has been established to examine the administration of all courts' trust moneys, including the issue of how such funds should be invested.