AUDITOR GENERAL

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VICTORIA

Auditor-General of Victoria

Special Report No. 11

Financial Assistance to Industry

March 1989

R. A Walker
COA (w).

VICTORIA

Report
of the
Auditor-General

SPECIAL REPORT NO. 11

FINANCIAL ASSISTANCE TO INDUSTRY

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AUDITOR GENERAL
VICTORIA

March 1989

The Honourable the Speaker
Legislative Assembly
Parliament House
Melbourne, Vic. 3002

Sir

Under the provisions of the *Audit Act* 1958, I transmit a report relating to financial assistance provided by government to industry in Victoria.

Yours faithfully

C.A. BARAGWANATH
Auditor-General

PREVIOUS SPECIAL REPORTS OF THE AUDITOR-GENERAL

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FINANCIAL ASSISTANCE TO INDUSTRY

PART 1

EXECUTIVE SUMMARY

1.1 FOREWORD

The release of the economic strategy by the Victoria Government in April 1984 provided an innovative framework for the development of the State for the next decade. Substantial claims have since been made by the Government concerning the broader success of the strategy in various published documents.

The purpose of this report, however, is not to extol the individual successes of the strategy. I recognise that this may lead to a view that the report is unduly negative and does not present a balanced overview of the strategy. However, it is a matter of public record that significant losses have been incurred in the implementation of the strategy. The purpose of the report is therefore to ensure that the mistakes of the past are not repeated and the various recommendations and observations in this report have been framed with this in mind.

While there are many aspects to the strategy and many successes, in this review I have confined my comments to the financial assistance provided to industry in Victoria in recent years and the problems arising therefrom.

A major concern arising from the findings of this review is the lack of adequate performance indicators at the Victorian Economic Development Corporation (VEDC) and the Department of Industry, Technology and Resources (DITR). While these agencies have a number of quantitative performance indicators, they seldom adopted indicators relating to quality of performance. For example, the extent to which financial assistance increased employment, promoted tourism and created additional export markets. Both types of indicators are necessary to give assurance that the financial assistance provided did in fact produce the desired results.

I recognise that there is a range of national indicators broken down on a State by State basis which provide a basis for the Government's view that the State is headed in the right direction with its overall strategy. However, these indicators do not provide assurance as to the success or otherwise of the specific programs within the strategy. I believe that the failure to progressively monitor the assistance provided to industry has contributed significantly to the poor performance of this segment of the economic strategy. If the paucity of the indicators is repeated in other agencies involved in the implementation of the strategy, then the Treasurer is not being provided with the information which is essential for making accurate and informed decisions as to the allocation of funds to ensure the objectives of the strategy are achieved.

Moreover, my recent review in relation to the Youth Guarantee Scheme, another key program in the strategy, also revealed serious weaknesses in the quality and reliability of information available at an agency level; in that case, the Department of Labour and the Victorian Post-Secondary Education Commission. These deficiencies lead me to conclude that a government priority should be to avoid the problems identified in this report from occurring in other arms of the economic strategy.

Prior reports of Auditors-General have drawn attention to performance and management problems within DITR and the VEDC in connection with financial assistance to industry, but appropriate action was not taken on those warnings.

It is essential that programs relating to the strategy are adequately monitored and evaluated to ensure that the Treasurer is supplied at all times with the information necessary to make sound economic decisions. I believe that this role falls properly within the responsibility of the Department of Management and Budget and 5 years after the release of the strategy, Victoria needs that role to be given higher priority.

As far as the losses incurred by the VEDC are concerned, as stated previously, the VEDC lacked appropriate performance indicators. However, the audit review indicated that the losses were primarily due to other factors, namely unrestricted access to borrowings prior to 1987-88, aggressive lending policies and the failure of the VEDC to follow the prudential requirements one would normally expect of a lending body.

No evidence was found during the review of any fraudulent activities by VEDC personnel.

In presenting this report to Parliament, I am conscious of the fact that there has been considerable speculation surrounding the losses incurred by the VEDC. In this context, the audit findings have disclosed that it was not until December 1988 that the full extent of the losses was quantified. However, there were sufficient indicators available to the VEDC Board as early as March 1988 which should have alerted a more prudent and competent management to the need to take prompt action to minimise further losses.

In conclusion, I note that the Premier in a Ministerial Statement dated 15 March 1989 has stated that industry assistance has not been as well controlled as it should have been in some areas and that in future the Government will ensure that industry assistance is tightly focused, firmly controlled and expertly managed. I welcome these developments.

1.2 SUMMARY OF MAJOR OBSERVATIONS

1.2.1 Key observations relating to the major areas of concern arising from the review of assistance provided to industry are set out below:

MATTERS PREVIOUSLY REPORTED

LACK OF ACTION
Despite mounting community pressure for greater accountability and effectiveness in the use of public moneys, problems relating to industry assistance previously reported by Auditors-General remained largely unresolved. *page 15*

STRATEGIC ISSUES IMPACTING ON INDUSTRY ASSISTANCE

RATIONALISATION AND EVALUATION OF LENDING ACTIVITY
The Treasurer was not provided with reliable information to gauge the effectiveness of industry assistance because suitable systems, monitoring procedures and performance indicators were not in place. *page 26*
There was a lack of consolidated information relating to assistance provided by various government agencies. *page 29*
The overlap of government agencies in the provision of industry assistance contributed to various inconsistencies and inefficiencies. *page 30*

DEPARTMENT OF INDUSTRY, TECHNOLOGY AND RESOURCES

REVENUE FOREGONE UNDER NEW PROGRAMS
In audit opinion, a loss to State revenue of approximately $30 million may occur because of the granting of interest-free loans in excess of entitlements to decentralised industry. *page 37*
Despite a departmental policy of "a sensible rate of interest", the actual rate of return on loans was considered to be unacceptably low. *page 53*

LENDING OPERATIONS
Financial assistance was provided to firms which in audit opinion were ineligible under policy guidelines contained in the economic strategy. *page 40*
Inadequate control over the loan portfolio existed due to serious deficiencies in the assessment and monitoring processes. *pages 41,49*

VICTORIAN INVESTMENT CORPORATION LIMITED

INADEQUATE ACCOUNTABILITY
The accountability to Parliament of VIC Ltd in terms of its responsibility for expenditure from the public purse needs to be urgently addressed. *page 55*

VICTORIAN ECONOMIC DEVELOPMENT CORPORATION

GROWTH IN OPERATIONS
Its expanded role, together with an unrestricted access to borrowings, contributed to the VEDC moving from being a prudent to an aggressive lender in a high risk environment. *page 58*
The growth of the VEDC was not adequately resourced, contributing to the decline in the quality of the assessment and monitoring of the loan portfolio. *page 61*

FINANCIAL PERFORMANCE
There was a large increase in the value of non-performing loans - in excess of $60 million relating to advances made in 1987-88. *page 70*
The VEDC suffered a dramatic downturn in its financial performance for the year ended 30 June 1988, incurring a loss of $105 million (30 June 1987, $1.9 million profit). *page 63*

CORPORATE MANAGEMENT
There was evidence that decisions of the VEDC Board had been circumvented by management. *page 69*
Lack of commitment by certain Board members contributed to the poor management performance of the VEDC. *page 68*

LENDING OPERATIONS
Due to serious deficiencies in the loan assessment process, financial assistance was provided to industry in an uncontrolled manner. *page 72*
Many decisions by the VEDC Board were contrary to the recommendations of lending officers. It can only be assumed that the Board either had available to it information which was not provided to audit, or that external forces had influenced the final decision. *page 78*
Deficiencies in the loan approval process and failure to regularly monitor loans contributed to the poor management of the investment portfolio. *page 79*
Additional funds were made available to borrowers who were already suffering financial difficulties. *page 84*
Instances were noted where funds were used by recipients for purposes other than those originally intended. *page 82*

OTHER FORMS OF ASSISTANCE
The decision by the VEDC to convert loans to equity increased rather than minimised its risk. It is estimated that in excess of 70 per cent of equity investments could be lost. *page 87*
The legal implication of issuing letters of comfort by persons other than the Treasurer needs clarification. *page 92*

PART 2

THE REVIEW

2.1

SCOPE OF THE REVIEW

2.1.1 In view of the importance of the economic strategy to the State, and the strategic role played by several public sector agencies in its overall development and initiation, this Office has conducted a review of the implementation and administration of certain aspects of the strategy.

2.1.2 The strategy comprises a number of segments such as tourism, transport and industry. This *Special Report* canvasses certain issues of importance relating directly to the industry segment of the State's economic strategy.

2.1.3 The audit review focused on the role of the following agencies in implementing the economic strategy:

- the Department of Industry, Technology and Resources;
- the Victorian Economic Development Corporation; and
- the Victorian Investment Corporation Limited.

2.1.4 In 1987-88, these agencies were responsible for administering a portfolio of loans and equity to Victorian industry in excess of $370 million. Grants and subsidies provided by these agencies were not included in the scope of this review. However, audit considers that certain of the problems identified in the review and the resulting recommendations would be applicable to the administration of grants and subsidies to industry.

2.1.5 Over recent years there has been increasing community concern about accountability for the use of public resources, a concern which Auditors-General have referred to frequently in successive reports to Parliament. In a number of those reports my predecessors expressed serious reservations about certain aspects of resource management within the above agencies. However, insufficient action had been taken in the past to rectify the problems audit identified and, hence, I considered that there was a need to again review the assistance to industry.

2.1.6 With a further 5 years of the economic strategy still to run it was desirable that the industry assistance scheme of the strategy be reviewed so that taxpayers can be assured in the longer term of the effective use of public moneys, and the positive contribution industry assistance can make to the growth of the State as a whole.

CONFIDENTIALITY VERSUS PUBLIC INTEREST

2.1.7 One issue which emerged strongly during the course of the review was the relationship between government agencies in their capacity as lenders and private enterprise as recipients of public funding.

2.1.8 It has been suggested to me that it is an accepted business norm to protect the commercial confidentiality of information which flows between a government agency and a private company. It was stressed that to do otherwise would compromise the commercial viability of such companies by exposing them to unfair competitive pressures in the marketplace.

2.1.9 The dilemma that I have been facing is to balance the notion of commercial confidentiality with the concept, well established under a Westminster style of government, that accountability to the Parliament and the taxpayers over the use and application of public moneys is paramount.

2.1.10 Should information relating to a substantial loan to a private company be treated any differently to information on the funding of a community program? There are 2 factors in common:

- both methods of funding come from the same source, i.e. the public purse, to which all taxpayers contribute; and
- both recipients have similar broad objectives of producing an outcome which ultimately benefits the community as a whole.

2.1.11 It follows, therefore, that there is one common link - the public interest - and this should not be overriden by considerations which focus on narrow and subjective aspects of self-interest by individual corporate entities.

2.1.12 In this report I have indicated that the potential conflict between the need to protect confidential information and the fundamental obligation for me to report to the Parliament may be more apparent than real, and that commercial confidentiality should never be accepted as negating my obligations to the Parliament and the taxpayers of Victoria.

2.1.13 Throughout the report, in considering whether a private company should be named or not, in every case I have taken into account the issue of public interest - whether it would be in the best interest of the public to be provided with such information.

2.2

MATTERS PREVIOUSLY REPORTED

2.2.1 One of the most significant responsibilities of Parliament and the Executive Government is to make decisions affecting the direction and management of the State's financial operations. The Auditor-General's role in this process is to provide independent reports which contain information on the adequacy of public sector organisations' financial and resource management systems designed to carry out those decisions, and to make recommendations for any corrective action.

2.2.2 As a result of previous audit examinations, my Office has been concerned for some time about the performance and management of several public agencies directly involved in the development and administration of the economic strategy of this State, including the Department of Industry, Technology and Resources (DITR), the Victorian Economic Development Corporation (VEDC) and the Victorian Investment Corporation Limited (VIC Ltd).

2.2.3 In particular, over the past 3 years audit has commented on a variety of issues dealing with management controls over the provision of financial assistance to industry. Summarised in this section of the report are matters arising from past audit reviews which had been brought to the attention of the relevant agencies, the Minister for Industry, Technology and Resources, and the Treasurer. In addition, the more significant of these issues have been reported to Parliament.

Department of Industry, Technology and Resources

2.2.4 In October 1986, DITR was informed of audit reservations relating to the provision and monitoring of incentive payments, loans and other assistance payments to industry and business. In its response to the audit report, DITR advised that the matters raised by audit would be included in an ongoing review being undertaken of the provision of grants, subsidies and incentive payments. The departmental review commenced in early 1987 leading to the development of a policy and procedure manual in May 1988. Following subsequent revisions, the manual was eventually formally issued in January 1989.

2.2.5 As pointed out in a special report on *Internal Audit in the Victorian Public Sector* tabled by the Auditor-General in December 1986, the effectiveness of management controls can be enhanced in an organisation by the use of an internal audit function. The Government directed in September 1987 that all departments establish an internal audit function within 12 months. However, DITR advised that due to staff freezes between November 1987 and April 1988 and after considering various options, it was not until March 1989 that an appointment could be made.

2.2.6 The delay in implementing the government directive has meant that certain deficiencies outlined later in this report could have been identified at an earlier stage.

Victorian Economic Development Corporation

2.2.7 As far back as 1982 an audit review of the VEDC found that there was a need for internal audit to place more emphasis on the examination of the VEDC's key activity, namely the provision and recovery of loans.

2.2.8 In his *Second Report for the year 1984-85* the then Auditor-General drew attention to the need for the VEDC to review the adequacy of its provision for doubtful debts. On this issue audit again expressed concern following examination of the VEDC's 1985-86 financial statements, and in 1986-87 provided closer scrutiny of the doubtful debts provisions. The 1986-87 review disclosed that:

- the ratio of non-performing loans to total loans had increased from 7.8 per cent in 1985-86 to 11.4 per cent in 1986-87 which necessitated an increase in the provision for doubtful debts;
- the continuing need to provide for further significant writedowns of the VEDC's loan portfolio in subsequent years would affect the VEDC's ability to maximise the availability of funds to new applicants and the success of the Government's industry assistance initiatives; and
- considering that financial assistance was being provided to entities where the associated risk was higher than the risk level normally accepted by other financial institutions, the procedures for managing the risk were deficient in the areas of:
  - guidelines which gave comprehensive direction as to VEDC policy and practice; and
  - procedures in the initial approval of loans, the monitoring of loans and the provision of further financial assistance to businesses already facing financial difficulties.

2.2.9 Before formally communicating the results of the 1986-87 audit of the VEDC, the Auditor-General on 18 December 1987 brought to the attention of representatives from central agencies his concerns about the VEDC's management procedures and the ability of assisted industries to repay loans.

2.2.10 It is understood that the Comptroller-General met with the VEDC's General Manager and Senior Manager, Administration in January 1988 to discuss the matters raised by the Auditor-General.

2.2.11 On 24 March 1988 the findings from the 1986-87 audit were formally conveyed to the VEDC, the Minister and the Treasurer, and included a summary of findings from a review of management control procedures over loans and equity investments. The detailed report of the review's findings had been forwarded to the General Manager of the VEDC.

2.2.12 The VEDC's response to the audit report was forwarded to the Minister for Industry, Technology and Resources on 26 May 1988. A copy of that response was forwarded to this Office, under covering letter from the Minister, on 22 June 1988.

2.2.13 With regard to non-performing loans, the response indicated that there would be a further significant writedown of the VEDC's loan portfolio in 1987-88. On the matter of management control procedures, the response stated that a policy and procedure manual was being prepared for issue in October 1988 and that the deficiencies identified by audit in loan evaluation had been addressed and new procedures implemented.

2.2.14 The *Fergus Ryan Report* to Parliament stated that had the audit recommendations been promptly acted upon, it is likely that losses could have been minimised by the prompt execution of damage control measures.

Government investigation of VEDC

2.2.15 On 9 November 1988 the Government announced that the Treasurer had commissioned an independent and expert investigation of certain fundamental matters concerning the VEDC due to mounting criticism and public concern over the apparently poor management and doubtful financial viability of the VEDC. The commencement of the investigation preceded the transfer of the assets and liabilities of the VEDC to the Rural Finance Corporation. The investigation, referred to in this report as the *Fergus Ryan Report*, was tabled in Parliament on 21 December 1988 and was critical of the management of the VEDC.

Victorian Investment Corporation Limited

2.2.16 In March 1987, and again in April 1988, Auditor-General's reports to Parliament drew attention to the absence of a requirement for government-owned companies such as VIC Ltd to present a report of their operations to Parliament. Yet, to date, no action has been taken by Parliament to redress what audit considers are deficiencies in the accountability processes to Parliament of organisations which have the use of funds provided directly or indirectly from the public purse.

2.2.17 In the Explanatory Notes relating to the *Treasurer's Statement* for 1987-88, the Treasurer stated: *"It is intended that companies, joint ventures and trusts which are not competing with private sector organisations in the open market will be audited by the Auditor-General at the request of the Treasurer under the Audit Act 1958. In order to maintain competitive equanimity, bodies competing in commercial markets would usually be audited by private sector accounting firms".*

2.2.18 The main features of the guidelines for public sector companies, joint ventures and trusts issued by the Government in October 1987 are:

- they apply to companies, joint ventures or trusts over which a Minister has control;
- prior to an agency creating or acquiring a controlling interest in such entities the approval of the Treasurer or Cabinet is required;
- each agency is required to prepare a "Statement of Objects", which is to be approved by the controlling Minister or Cabinet;
- audited financial statements of such entities are required to be tabled in Parliament except for information which the Minister considers to be commercially confidential; and
- a register of such entities is to be maintained by the Department of Management and Budget (DMB).

2.2.19 Reference to "commercial confidentiality" in support of government use of companies raises a potential conflict between the need to protect confidential information and the fundamental obligation to provide adequate disclosure to the Parliament.

2.2.20 It is suggested that this conflict may be more apparent than real, as commercial confidentiality should never be accepted as negating disclosure and accountability obligations.

2.2.21 In November 1986 the Victorian Economic and Budget Review Committee, in a report entitled *Accountability Requirements Affecting Subsidiary Companies of Government Organizations with Special Reference to V/Line Industry Pty Ltd*, addressed the question of whether consideration of commercial confidentiality should override full public accountability for funds invested. The argument for preserving commercial confidentiality was based largely on the concern that public disclosure of commercial information, using standards of reporting applicable to public sector entities, would adversely affect a company's competitive position or negotiating power.

2.2.22 The Committee concluded that where significant moneys were invested in government-owned companies, accountability to the Parliament should be paramount and that the accounts of such companies should be audited by the Auditor-General. The report of the Committee also illustrated that the powers and scope of activities of government-owned companies can substantially exceed those of the statutory powers of the parent public body, thereby effectively extending the authorised powers and activities beyond those originally envisaged in the enabling legislation.

2.2.23 Despite the above recommendation of the Committee the accounts of VIC Ltd continued to be audited by a private practitioner rather than the Auditor-General.

2.2.24 This is not to suggest that the private auditor is not as concerned to maintain the integrity of the auditing function as the Auditor-General. Hence, it is no reflection on private auditors to suggest that the accountability of government companies is not adequately served by private auditors reporting under the Companies (Victoria) Code. The reason lies elsewhere, namely in the comparatively abridged reporting requirements of the Companies (Victoria) Code.

2.2.25 The reporting requirements of the Companies (Victoria) Code are confined to an attestation as to the truth and fairness of the company's financial statements. Thus, that attestation is the focus of the private auditor's attention and the central objective of his audit. By contrast, the Auditor-General carries out the audit of the company, attests to its financial statements, reports on its operations to the Board and the relevant Minister and includes a reference to the audit findings in his Report to the Parliament.

2.2.26 Because of convention and legislative mandate the Auditor-General performs additional functions in the audit of a company such as a review of the efficiency and effectiveness of its operations. This would normally be done by a private firm on a separate consultancy basis. Hence, it is clear that the audit performed by the Auditor-General covers a wider spectrum when compared with the obligations of a company auditor. In that sense accountability of government companies is not adequately served by private auditors reporting only in terms of the requirements of the Companies (Victoria) Code.

Management response by DMB

Important developments not adequately covered in the report include:

- *the commissioning on 24 March 1988 of the* Arthur Young Report*;*
- *the receipt of that report by the VEDC Board on 28 April 1988;*
- *the subsequent substantial implementation of the recommendations of the* Arthur Young Report*;*
- *the actions announced by the Government on 24 October 1988 to merge the operations of the VEDC with the Rural Finance Corporation (RFC) and the appointment of a common Board to the VEDC and RFC; and*
- *the Treasurer's statement to Parliament on 21 December 1988 which covered the Government's initial financial and managerial response to the* Fergus Ryan Report.

2.3

GOVERNMENT ECONOMIC STRATEGY

THE STRATEGY

2.3.1 In April 1984, the Victorian Government released its economic strategy for Victoria. The major objectives of the strategy were to maximise long-term growth in income and employment.

2.3.2 Employment was to be boosted by improving the competitiveness of the Victorian economy with the introduction of measures aimed at promoting economic development in specific areas of industrial and economic strength. The anticipated higher levels of employment and increases in exports were projected to contribute to an overall increase in disposable income.

2.3.3 The trade-exposed sector of the Victorian economy was perceived as the crucial sector to be revived if the State was to achieve its prime economic goal of growth in income and employment. This would involve Victorian industries becoming more competitive both interstate and overseas.

2.3.4 The Government's *Technology Statement*, issued in July 1986, confirmed the importance it placed on increasing economic activity over future decades. The 3 main areas of technology development identified were:

- information technology (including microelectronics and tele-communications);
- biotechnology; and
- advanced industrial materials.

2.3.5 The Government established a program to build increased commercial development on Victoria's research base and to accelerate the incorporation of new technology into Victorian industry through the policies and programs outlined in the *Technology Statement*.

2.3.6 In April 1987, the Government released an updated revised version of the economic strategy.

2.3.7 The strategic objectives of the original statement *"...to increase the long-term rate of growth in income and employment by improving competitiveness of the trade-exposed sector"*, were confirmed for the second stage of the strategy. The distinctive features of the second stage of the economic strategy were:

- more direct targeting of export growth;
- the development of a more quantitative focus to the economic strategy; and
- a systematic attempt to draw out and address some of the implications of long-term, internationally-oriented growth.

Industry segment of the strategy

2.3.8 The economic strategy comprises a number of distinct but interrelated segments, each of which address a specific aspect of community interest. The areas of focus of the audit review covered the industry segment of the overall strategy and, more specifically, industry policies and capital markets.

2.3.9 Industry policies focused on firms operating in the trade-exposed sectors of manufacturing and tertiary industries to assist them to gain access to new markets and to improve their competitiveness in these markets. The policies were targeted at small to medium-sized firms with growth potential and highly protected industries with a capacity to improve their growth prospects. The policies included both facilitative mechanisms and direct financial assistance.

2.3.10 The funding for the policies was to be provided from the savings achieved by phasing out the old and ineffective forms of industry assistance with attention being given to re-ordering priorities and increasing efficiency rather than the provision of additional recurrent resources.

2.3.11 The Government in its economic strategy determined that it would provide assistance to companies where the capital market was deficient in its capacity to provide funds. This assistance included:

- supply of equity funds and management support for companies with growth potential, i.e. venture capital;
- supply of longer-term debt capital to small to medium-sized firms on reasonable terms and conditions; and
- specific types of development finance such as export pre-shipment finance for small to medium-sized companies.

ROLE OF GOVERNMENT AGENCIES

2.3.12 The role of government agencies with prime responsibility in the development and administration of the industry segment of the economic strategy are discussed below.

Department of Industry, Technology and Resources

2.3.13 The Department of Industry, Technology and Resources (DITR) was identified as the focal point for private sector contact with the Government in respect of economic development and, in conjunction with the Victorian Economic Development Corporation, was responsible for providing assistance to growth firms and to firms in need of restructuring and revitalisation.

2.3.14 The Minister for Industry, Technology and Resources and/or DITR had a clear role to:

- advise on the objectives, plans and strategies for the growth of Victoria's manufacturing and commercial sectors together with the relationship between general government policies and industry development, and the effect of this on the ordering of overall priorities;
- develop, monitor and review policies and programs affecting industrial development, particularly their effect on specific industries and regions; and
- provide finance to industry and act as a catalyst for business and technology development in Victoria.

Victorian Economic Development Corporation

2.3.15 The Victorian Economic Development Corporation (VEDC) was established under the provisions of the *Victorian Economic Development Corporation Act* 1981 to facilitate and encourage the development of Victorian industry.

2.3.16 On 1 July 1984, in line with the Government's economic strategy, the VEDC was restructured to become the principal agency for the provision of targeted loans and equity funds to Victorian businesses. Essentially, the role of the VEDC was to *"... increase its presence in the capital market and to operate on commercial lines while taking more risks than would be acceptable to conventional financial institutions"*. Finance was to be provided to firms which were not able to attract adequate or appropriate funds where this was not necessarily attributable to management or product weaknesses.

2.3.17 While the strategy encouraged the VEDC to take more risks, the Government nevertheless *"... retained the power to monitor closely the implementation of the measures to ensure that the capital reconstruction of the VEDC achieved the government's objectives of expansion of activities without altering the corporation's existing criteria of prudent management and appraisal"*.

2.3.18 The objectives of the VEDC generally related to the stimulation of the State's economy through the provision of loan, leasing and equity finance to innovative companies with domestic and international growth prospects. However, the Government stated that: *"... it was concerned to ensure that the delivery of financial services by organisations such as the VEDC, the State Bank, and the Rural Finance Commission was comprehensive and well directed, particularly on a regional basis, and was carried out with a minimum of overlap of functions".*

Victorian Investment Corporation Limited

2.3.19 The company was initially established as a wholly-owned subsidiary of the VEDC to provide a commercial vehicle for government investment in new scientific and technology-based businesses. Through the company, the Government has taken equity positions to provide venture capital to such businesses.

Department of Management and Budget

2.3.20 The Department of Management and Budget was created by the Government to oversee both the development and implementation of its economic strategy. It was also to play a vital role in ensuring that the level of resources allocated to particular programs reflected their importance in pursuing the social and economic goals of the Government and that evaluations of the success or otherwise of the programs were undertaken.

2.3.21 The Treasurer was assigned a central role in overseeing implementation of the economic strategy at a macro level. The Treasurer's specific responsibility was to ensure that budget processes and policies which covered areas dealing with finance, public authorities and asset management were integrated with the economic strategy. These functions were seen as important because: *"To be successful the economic strategy cannot be simply an overlay of the existing processes of the Government. It requires a consistent and continuing co-ordination of government policy in all areas towards the economic objectives".*

2.3.22 The development of improved systems of financial management under the broad responsibility of the Treasurer were seen as essential if an overall economic strategy was to be successfully implemented in Victoria.

2.4

STRATEGIC ISSUES IMPACTING ON INDUSTRY ASSISTANCE

This section of the report contains comments relating to:

- Adequacy of evaluation of the achievement of industry assistance;
- Availability of consolidated loan information; and
- Overlap of lending functions by government agencies.

ADEQUACY OF EVALUATION OF THE ACHIEVEMENT OF INDUSTRY ASSISTANCE

2.4.1 The Victorian Government considers the ongoing evaluation of public sector programs as vital in assessing their efficiency and effectiveness. As such, the establishment of adequate performance indicators is an integral part of the Government's budgeting strategy and a clearly stated responsibility of public sector managers. In the context of the economic strategy the Treasurer has a central role in overseeing the implementation of the economic strategy at a macro level.

2.4.2 The Treasurer's specific responsibility was to ensure that budget processes and a number of government policies were integrated with the economic strategy. In conjunction with these responsibilities, there was recognition of the need to strengthen within the Department of Management and Budget (DMB) and elsewhere the capacity to review programs in the light of government objectives generally, and economic objectives in particular. The successful development and operation of improved systems of financial management within DMB was crucial to providing the Treasurer with the capacity to exercise his responsibilities in overseeing the implementation of the economic strategy.

2.4.3 The publication *Victoria: The Next Step*, released in April 1984, also stated that the Minister for Industry, Technology and Resources had direct responsibility through the Department of Industry, Technology and Resources (DITR), the Victorian Economic Development Corporation (VEDC) and the Victorian Tourism Commission for the implementation of new policies developed in the context of the economic strategy. In particular, DITR was identified as having a key role in developing, monitoring and reviewing industry assistance. Industry assistance programs were seen by the Government as requiring continuous monitoring and regular modification in order that programs meet their objective in assisting firms to become internationally competitive.

2.4.4 Despite the Government's emphasis on program development and evaluation, DITR had not developed a comprehensive process of measuring and monitoring the impact of providing substantial funding in the form of industry assistance packages to Victorian industry. While DITR maintains that it evaluates the effectiveness of schemes of assistance, in the absence of effective monitoring as referred to later in this report, comprehensive current data would not be available to gauge the success of the schemes in stimulating the economy in line with the Government's economic strategy.

2.4.5 In the *Annual Reports* of DITR over the past 3 years various claims were made about the benefits arising from the industry assistance schemes. As an example, the 1986-87 *Annual Report* stated in relation to the granting of industry assistance totalling $7.1 million that: *"This assistance generated $28.1 million of additional investment by the recipients and resulted in the creation of 419 new jobs and the retention of another 2 222 throughout the State".*

2.4.6 Audit established that the above figures were based on data collected from firms at the application stage and prior to the commencement of projects. Due to either the lack of, or inadequate, monitoring subsequent to the provision of assistance, DITR did not substantiate whether in fact this growth did occur. On occasions where monitoring did take place instances were noted where a firm's job creation and retention performance was substantially less than claimed in the original submission.

2.4.7 Audit recognises that a degree of success has been achieved with the economic strategy as partly evidenced by a recent survey by DITR of 10 firms referred to in this report. However, the extent to which this success could be attributed to the programs of DITR and its agencies as compared with other economic factors could not be properly evaluated. Due to the lack of reliable performance data it was considered that DITR's claims of job stimulation and industry investment in line with the economic strategy were optimistic, particularly as:

- there was a general tendency of firms to overstate the level of job creation and retention in support of funding applications;
- in many instances DITR claimed responsibility for total project achievements but only provided a portion of a firm's capital requirements;
- in a number of instances DITR provided assistance and claimed credit for projects that had already commenced prior to funding being granted;and
- comprehensive management information systems were not in place to record data which may have indicated the extent to which industry assistance was successful, both on an aggregate and individual project basis.

2.4.8 The VEDC established quantitative targets at the beginning of each financial year in relation to specific percentages of overall financial assistance to be provided to various industry groups, e.g. industry in need of revitalisation, decentralised industry etc. The extent to which these lending targets were met was regarded as a measure of performance in relation to whether the VEDC was meeting its lending objectives. This information was included in the VEDC's *Annual Report*.

2.4.9 Audit considered, however, that quantitative targets were not a proper measure of performance as they did not indicate whether the assistance provided was effective in terms of employment creation and stimulation of sales, tourism and exports. In other words, it was not possible to specifically determine whether the assistance provided by the VEDC achieved its intended purpose and had the desired impact in terms of the Government's economic strategy.

2.4.10 In light of the above factors it is doubtful whether the Treasurer is being provided with reliable information which would enable him to determine the success or otherwise of the economic strategy.

2.4.11 The lack of qualitative performance measurements and shortcomings in program evaluation was considered by audit to be a serious deficiency in that the Treasurer and the Minister were not always provided with information which would enable them to determine:

- **whether further assistance could be justified;**
- **the relative values of allocating assistance to specific industry groups as opposed to others; and**
- **whether policy and program objectives were being effectively met in accordance with economic strategy objectives.**

Management response by DITR

Attention is drawn to the relevant sections of "Victoria: The Next Step", "Trading on Achievement" *and* "Victoria: The Next Decade" *which assess the impact of DITR assistance programs on employment, exports and investments.*

A recent assessment of the 10 companies examined in the audit report showed that DITR assistance had been associated with a net increase in investment in Victoria, by the companies of $32 million, and a net increase in employment in Victoria (mainly rural Victoria) of 302 persons.

Several independent evaluations of the effectiveness of schemes of assistance have been undertaken, e.g. Evaluation of the Business Planning Scheme, Industrial Supplies Office *and* Heavy Engineering Assistance.

DITR has had an evaluation function in its Business Policy and Planning Unit whose primary task is the detailed evaluation of programs and projects.

However, DITR acknowledges that there was a need for a more comprehensive program of assessment and evaluation and better systems to assist in this process. Internal reviews are currently addressing this issue.

2.4.12 The Auditor-General's *Second Report* to Parliament for the 1986-87 year drew attention to the absence of centrally available information on assistance provided by the State's various lending authorities to individual entities. The absence of such a central database impacted upon the ability of lending agencies to establish and monitor the total amount of assistance provided by the State to individual entities.

2.4.13 The *Second Report* also drew attention to the potential risk of entities obtaining assistance from various State agencies which, on a cumulative basis, they may not have been entitled to receive.

2.4.14 In recent years the public sector has provided substantial financial assistance to Victorian industry in the form of loans, equity, grants and subsidies. This assistance to industry has been contributed through programs administered by agencies such as DITR, VEDC, Rural Finance Corporation (RFC), Small Business Development Corporation, State Bank and the Victorian Investment Corporation Limited (VIC Ltd).

2.4.15 It was noted by audit that many entities received loans from more than one agency, e.g. one firm had received financial assistance from 3 sources (DITR, VEDC and VIC Ltd).

2.4.16 Although it is acknowledged that the criteria for eligibility for financial assistance can vary between programs administered by individual agencies, information on the overall level of funding already provided by the State to individual entities is considered by audit to be an essential factor when applications for assistance are considered.

Management response by DITR

DMB is investigating the feasibility of setting up a central register of financial assistance to firms by all government agencies. DITR has indicated support for this proposal subject to appropriate mechanisms to ensure the confidentiality of "commercially sensitive" information.

DITR is upgrading its subsidy ledger for all financial assistance packages to provide information directly to the proposed DMB central register.

OVERLAP OF LENDING FUNCTIONS BY GOVERNMENT AGENCIES

2.4.17 Government agencies involved in the provision of assistance to industry included DITR, VEDC, Small Business Development Corporation, VIC Ltd, State Bank and RFC.

2.4.18 Although eligibility criteria for assistance can vary between agencies and programs, in essence the objectives of the abovementioned agencies in relation to the provision of industry assistance loans are similar. In line with the Government's economic strategy, industry assistance loans are provided to assist firms to improve their competitiveness and/or growth potential where circumstances have precluded the provision of loan finance from traditional sources, e.g. trading banks.

2.4.19 In its economic strategy as outlined in *Victoria: The Next Step*, the Government stated in 1984 that it was concerned that the delivery of financial services by organisations such as the State Bank, VEDC and RFC should be comprehensive and well directed with a minimum of overlap of functions.

2.4.20 Audit considers, however, that over recent years an overlap of functions has evolved, particularly in relation to the lending activities of DITR and the VEDC. Both agencies were required to assess the economic viability of funding proposals, evaluate the management and business acumen of applicants, maintain similar financial and administrative records, monitor performance, provide inspectorial and liaison services with firms and report to the Minister. The administrative infrastructure of lending activities of both agencies is essentially similar.

2.4.21 The overlap of functions has also brought about certain inconsistencies in loan administration policies. As an example, as part of the buy-out of decentralisation benefits, DITR provided a number of interest-free, industry assistance loans for periods of up to 30 years. However, there was no evidence to suggest that DITR attempted to reduce the repayment periods of loans as was the practice in other agencies. By way of contrast, it was noted that on average, the term of loans provided by agencies such as the VEDC and RFC varied between 3 and 9 years.

2.4.22 In addition to the abovementioned agencies, the Victorian Women's Trust Ltd also provides assistance to industry, albeit on a minor scale, through the provision of guarantees of up to 50 per cent of loans issued by the State Bank to women establishing businesses within Victoria. The maximum guarantee is $20 000 and is provided in circumstances where the businesses concerned are owned or controlled by women and finance is not available from trading banks.

2.4.23 The Victorian Women's Trust Ltd was established with a $1 million gift from the Government in 1985. With regard to accountability, the Trust as an incorporated association, it is not required to report to Parliament and although audited by private auditors the 1987-88 *Annual Report* of the Trust does not contain audited financial statements.

2.4.24 In view of the overlap of functions, it is considered that government lending to industry needs to be rationalised. Advantages from such a process could include more efficient use of resources, development of specialist staff, centralised databases and management information systems, and enhanced monitoring and reporting provisions.

Management response by DITR

DITR maintains that the role relationship between DITR and VEDC has been quite clear in government policy documents published since April 1984.

The relevant future role of DITR and RFC were spelt out in the Premier's statement of 15 March 1989. The key points are:

- *The Government will withdraw from any general role in the provision of venture capital to firms;*
- *The RFC will concentrate on a development finance role involving the provision of loans and other related assistance; and*
- *Assistance provided through DITR will in future be on a grant basis and not by provision of either loans or equity. No new loans will be made by DITR. The target for DITR grants will be set by government within the economic strategy framework.*

2.5

DEPARTMENT OF INDUSTRY, TECHNOLOGY AND RESOURCES

This section of the report contains comments relating to:

- Role in financial assistance to industry;
- Revenue foregone under new programs;
- Lending operations;
- Rate of return on loan funds; and
- Financial recording and reporting.

2.5.1 The Department of Industry, Technology and Resources (DITR) is the central agency for implementing the Government's economic strategy, with its programs directed towards conservation and management of Victoria's energy and mineral resources, and helping to improve the technological competence and manufacturing competitiveness of Victorian firms.

2.5.2 Under DITR's *Services to Industry and Commerce Program*, loan assistance was basically provided to industry in the following forms:

- long-term, interest-free loans provided in lieu of decentralisation benefits, such as payroll tax rebates, land tax rebates and freight subsidies which were progressively phased out from 1984;
- interest-bearing loans resulting from the targeting of industries in need of assistance in order to remain competitive, or to assist growth; and
- a combination of both interest-bearing and interest-free loans, provided to individual firms in relation to the phasing-out arrangements and additional industry assistance.

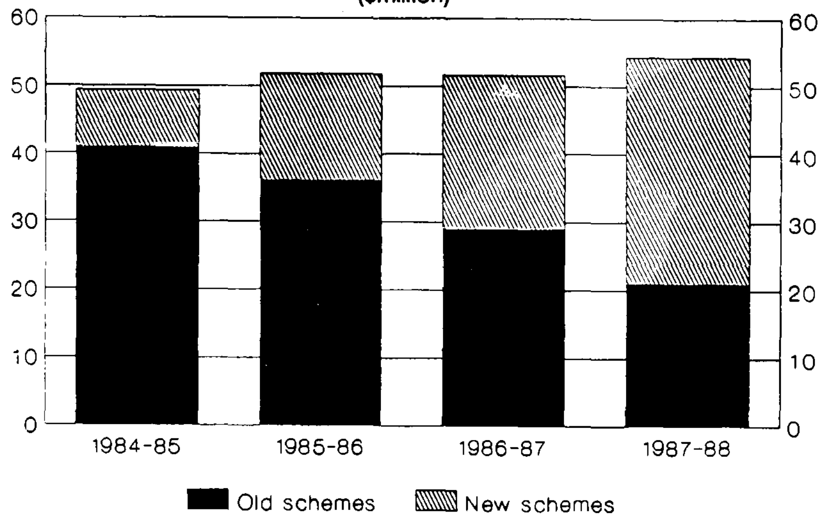
2.5.3 The industry segment of the Government's economic strategy was largely directed towards small to medium-sized firms with growth prospects, where venture capital was not available from traditional sources. In audit opinion DITR's role was, in effect, to act as a "lender of last resort" in the provision of high risk financial support. **However, despite this role, it was noted that departmental case officers actively encouraged targeted firms to seek financial assistance in the first place from DITR. Audit considered that this action was incompatible with the role of "lender of last resort".**

2.5.4 In addition to loans, DITR also provided assistance in the form of interest subsidies and grants. Total expenditure in connection with industry assistance in 1987-88 was $54.4 million (1986-87, $51.7 million).

2.5.5 Chart 2.5A indicates industry assistance expenditure since 1984-85 allocated between the "old" programs involving decentralisation benefits such as payroll tax subsidies, freight rebates etc., and assistance provided under the "new" programs announced in 1984, which were directed towards growth firms, industry revitalisation and special assessment needs of individual firms.

CHART 2.5A. ALLOCATION OF INDUSTRY ASSISTANCE UNDER "OLD" AND "NEW" PROGRAMS

($million)



Source : Department of Industry, Technology and Resources.

2.5.6 The amounts shown in the above chart include assistance provided in the form of loans. Table 2.5B discloses outstanding loan balances at 30 June for the past 4 years:

TABLE 2.5B. OUTSTANDING LOAN BALANCES

($million)

	At 30 June -			
Item	*1985*	*1986*	*1987*	*1988*
Loan balances due	5.5	14.1	24.2	28.7

2.5.7 In DITR's *Annual Report* for 1987-88, reference was made to the need to continue to professionally deliver services and programs and at the same time enforce stringent standards of evaluation and accountability for every dollar spent on industry assistance, in order that the benefits of this assistance were demonstrated and measurable. The audit review disclosed that these objectives were not satisfactorily achieved, due mainly to inconsistent interpretation of government policy, poor direction as to processes and procedures, and the lack of commitment to monitoring and performance evaluation of loans.

Management response by DITR

The State economic strategy documents show that DITR was neither charged to act as a commercial lender, nor is it a "lender of last resort".

However, it has been a pro-active provider of subsidies and services to business in pursuit of industrial development objectives. DITR was strongly encouraged to promote the availability of the new programs. Seeking out target firms and working with those firms to improve their prospects of successfully pursuing growth and revitalisation opportunities was a direct intention of the State economic strategy which seeks a fundamental change to Victoria's income growth and export performance.

Consistent with policy objectives of drawing as far as possible on the regular channels of development finance (VEDC, AIDC, RFC), direct financial assistance was offered only to a small number of the firms which were approached and/or assessed by DITR.

Furthermore, DITR initiated some senior management changes in October 1988, and the new Minister approved 2 major internal reviews in November 1988. These reviews have led to revisions in policies, programs and procedures and the publication of a new manual in January 1989. From March 1989 DITR has had its role revised by the Premier to provide grants only, and not loans. The policy and procedures manual is being revised to account for this.

2.5.8 Following the government decision announced in 1984 to phase-out decentralisation benefits over a 3 year period, the level of benefits payable to firms by DITR was progressively reduced. Where a decentralised firm was able to demonstrate that withdrawal of these benefits had significantly affected its operations, adjustment assistance was made available in the form of either grants, loans or subsidies. Departmental policy stated, however, that the level of adjustment assistance provided was not to exceed the total level of decentralisation benefits that would have been payable had the decentralised industry scheme continued for the 3 year period. Due to taxation implications adjustment assistance, where warranted, was often provided in the form of interest-free loans.

2.5.9 Government policy also stated that in addition to the phase-out arrangements, all decentralised operations were eligible to receive assistance under new programs announced in the State and Regional Industry Policies. Assistance under these new programs was to be subject to certain eligibility criteria and varying degrees of flexibility in relation to security, interest rates and repayment schedules. Departmental guidelines provided for this assistance to decentralised firms to be provided under the *normal terms and conditions applicable to the new programs.*

2.5.10 However, where assistance was provided under new programs, firms were expected to forego any entitlement to adjustment assistance, and were encouraged to forego remaining benefits payable under the phasing-out of the decentralised industry scheme. **DITR's subsequent interpretation of the government policy statements resulted in many instances where long-term, interest-free loans were granted far in excess of a firm's entitlement to decentralisation benefits and adjustment assistance.** An example is set out below:

Stafford Holdings Pty Ltd

The company received an interest-free, 30 year loan of $4 million in return for foregoing adjustment assistance and decentralisation benefits amounting to $440 000. **Assuming an interest rate of 15 per cent, the interest foregone by the State over the term of the loan will be approximately $15 million.**

2.5.11 Other examples are shown in Table 2.5C below:

TABLE 2.5C. ASSISTANCE PROVIDED COMPARED WITH DECENTRALISATION BENEFITS FOREGONE

($)

Firm	*Amount of decentralisation benefits foregone*	*Total interest-free assistance provided by DITR*	*Excess funds provided interest-free*
Pacific Dunlop	346 000	*(a)* 1 250 000	904 000
Onkaparinga Woollen	386 000	*(b)* 1 000 000	614 000
Murray Goulburn	4 485 000	*(b)* 4 900 000	415 000
Fletcher Jones	1 211 000	*(b)* 2 500 000	1 289 000

(a) Interest subsidy.
(b) Interest-free loans.
Note: Special Industry Development Grants are not included in the calculation of decentralisation benefits foregone as they were not introduced until May 1987, up to 2 years after the above assistance was provided.

2.5.12 The decision to provide additional assistance to decentralised firms in line with program objectives is not questioned by audit. However, the decision to provide this assistance on an interest-free basis without a specific policy direction from government was not considered by audit to be compatible with a stated objective of obtaining a reasonable return on public loan funds.

2.5.13 It was estimated by audit that interest foregone by the State in relation to interest-free loans provided in excess of entitlements to decentralisation benefits will be approximately $30 million over the term of these loans.

Management response by DITR

Most of the loans provided involved the buy-out of decentralisation benefits. The total loan provided to firms comprised 2 components:

- *the entitlement of the companies under the decentralisation phase-out including adjustment assistance; and*
- *entitlements under the new programs announced by the Government in 1984.*

The decentralised companies were clearly entitled to both of these components as outlined in Minister Cathie's announcement of the decentralisation phase-out and introduction of the Government's new programs in 1984. Page 6 of the Government economic strategy document "State and Regional Industry Policies" states:

> *"Firms currently receiving decentralisation incentives will also be eligible to receive assistance under the new programs which I will announce here. Indeed, some of these programs have been specifically targeted to firms receiving decentralisation incentives".*

Where amounts over and above the levels of decentralisation entitlements alone were paid, they were negotiated with the firm to ensure that the firm undertook approved projects consistent with the State economic strategy, and that the firm forfeited its rights to any ongoing entitlements under the Decentralisation Scheme or subsequent government policy statements.

DITR also considers that rather than causing a loss to government from the buy-out of decentralisation benefits, it estimates that for the 10 companies alone mentioned in this report, the savings to government are estimated at $1.504 million per year at present day values. The net present value (at a 4 per cent real discount rate) of this annual saving is $37.6 million.

Clearly when all companies in the program are considered, the buy-out process represented a very large saving to the Victorian Government.

It should also be noted that these calculations do not take into account the substantial economic benefit of redirecting the money saved from the previous non-targeted decentralisation incentives programs to the Government's targeted programs.

Further audit comment

While audit acknowledges that in the terms of the policy statement, decentralised firms were eligible for assistance under new programs, this factor should not have precluded the firms from satisfying criteria set in the economic strategy, nor should they have been exempt from the normal terms and conditions applying to assistance under these new programs. This viewpoint was supported by evidence on DITR files that indicated that certain firms were not entitled to assistance, although assistance was subsequently provided.

Notwithstanding the advantages to the State achieved from the phase-out of decentralised benefits, the decision to provide additional assistance on an interest-free loan basis will result in interest revenue being foregone by the State.

ASSISTANCE PROVIDED CONTRARY TO POLICY GUIDELINES

2.5.14 The Government's economic strategy relating to industry assistance was largely directed towards small to medium-sized firms with growth prospects but limited access to finance. To reflect this direction, DITR's policy guidelines for new programs including the *Growth Firm* and *Industry Revitalisation Programs* stated that:

- a justifiable need for assistance must be established by a firm on the grounds that internal funding was inadequate and sufficient funding was not available from financial institutions to enable projects to be undertaken;
- *generally* a firm will be small to medium-size, employing less than 200 people and not have a net worth greater than $5 million; and
- assistance shall not be available to publicly listed companies or subsidiaries of publicly listed companies.

2.5.15 Instances were found where financial assistance was granted to companies which were ineligible in terms of DITR's own policy guidelines as outlined above. Several firms were found to have a net worth far exceeding $5 million and employing up to 1 000 employees. An example of the failure to apply guidelines is set out below:

Onkaparinga Woollen Co. Ltd

The firm, **which was a subsidiary of a major publicly listed company (Industrial Equity Ltd), was provided with a 15 year interest-free loan of $1 million** in order that it could upgrade certain plant in 2 broad stages costing $625 000 and $376 000, respectively. Examination of file documentation indicated that prior to seeking financial assistance from DITR:

- equipment for the $625 000 stage of the project had already been ordered, finance for which the parent company could have provided; and
- vendor finance was used to purchase equipment involved with the $376 000 second stage.

As the firm apparently was able to finance its expansion, audit could not understand why an interest-free government loan was provided, particularly as the project had already commenced. In addition to the firm's ability to finance its own expansion, the firm did not meet the other criteria in that it employed approximately 350 persons and was the subsidiary of a large publicly listed company.

Correspondence from the Minister for Industry, Technology and Resources requesting the Treasurer's approval for the loan stated that: "... the proposal was fully consistent with the revitalisation assistance program of the State and Regional Industry Policies". The correspondence did not draw the Treasurer's attention to the fact that the proposal did not meet DITR's eligibility criteria for assistance as outlined above.

DITR has indicated that the above transaction was designed to "phase-out" decentralised industry subsidy obligations as well as to provide an example (through appropriate publicity) of how the new government industry assistance programs could be of assistance to country Victoria.

2.5.16 Audit acknowledges that on occasions financial assistance to firms may be justified by DITR although eligibility criteria are not fully met. However, where such circumstances prevail, reasons for supporting such decisions should be provided to the Minister and the Treasurer.

2.5.17 Failure to consistently apply criteria or to document reasons where criteria were not to be applied resulted in:

- **financial assistance being provided which was incompatible with the Government's economic strategy;**
- **Treasurer's approval being given for loans, which, if all circumstances were brought to notice, may not have been approved;**
- **the limited loan funds available to assist industry not being applied in the most effective manner; and**
- **ambiguity within DITR as to the interpretation of policy guidelines for assistance.**

Management response by DITR

DITR rejected the audit viewpoint, stating it believed that the programs and guidelines were clearly framed. DITR states again the clear policy directive from the Government in Minister Cathie's covering statement of April 1984, when he announced the new Government Industry and Regional Policies:

> *"Firms currently receiving decentralisation incentives will also be eligible to receive assistance under the new programs which I will announce here. Indeed, some of these programs have been specifically targeted to firms currently receiving decentralisation incentives".*

Further audit comment is included under paragraph 2.5.13.

LOAN APPLICATION AND EVALUATION PROCESSES

2.5.18 The proper evaluation and assessment of loan proposals is crucial to determining the level of assistance required and involves assessing the viability of businesses and risks involved, financial return to the State and whether the provision of assistance complements the Government's economic objectives. As part of the loan evaluation process DITR employs "case officers" to evaluate proposals and provide recommendations as to the type of assistance package required.

2.5.19 A review of documentation relating to loan application and evaluation processes indicated the following:

- Submissions from firms were often lacking in quality, did not follow a prescribed format and lacked basic financial information considered by audit to be essential for assessment purposes. This situation in part resulted from the failure of DITR to utilise standard application forms and to prescribe minimum information to be included in submissions;
- The standard of reports prepared by case officers varied considerably, often with little attention being given to whether firms were eligible for assistance in accordance with departmental criteria;

- Information supporting loan applications was often accepted by case officers without validation;
- Evidence was not available to indicate whether work undertaken by case officers was subject to internal quality control; and
- File tracking procedures were poor and security over confidential information was inadequate.

2.5.20 Despite an awareness of certain of these deficiencies, inadequate attention was given by DITR to initiating corrective action.

Management response by DITR

Under the new industry assistance schemes that have evolved it is acknowledged that more standardised collection of information from clients could be beneficial and procedures are currently under review.

Decentralised firms were considered to be automatically eligible to the buy-out of adjustment assistance and access to new programs. Eligibility criteria was not considered relevant.

Evaluation and checking procedures are being further examined and appropriately strengthened as the industry program alters direction.

Although DITR considered that there was review and discussion on negotiated packages, it was acknowledged that the high workload limited its ability to conduct quality reviews.

DITR has a computerised file tracking system and considers it maintains adequate security over its files.

2.5.21 DITR's policy guidelines and procedures did not require that credit checks and evaluations of past business history be conducted prior to recommendations being given to the Minister as to loan approvals. The fact that credit worthiness and financial stability checks were in many instances not conducted by DITR prior to approving loans increased the risk of non-recovery of public funds.

2.5.22 To date, the incidence of firms defaulting on loans has been low. However, it needs to be borne in mind that:

- in most instances repayment of principal is not due until the expiration of the loans periods, which vary between 3 and 30 years;
- many loans were interest-free and consequently monitoring by virtue of the receipt of regular remittances was not available;
- inadequate monitoring was common in relation to firms in receipt of industry assistance loans; and
- the practice in some instances for interest not to be paid in the first few years but to be added to the value of the loan also meant that monitoring of the initial ability of a firm to repay a loan was restricted.

2.5.23 In view of the above factors, the ability of DITR to identify doubtful debts at an early stage is severely restricted.

2.5.24 The consequences of failing to perform credit checks or to take into account an applicant's previous business history can be illustrated by the following example:

Gleason Cranes (Vic.) Pty Ltd

In May 1986 the firm obtained an unsecured loan of $100 000 from DITR. A credit check of the applicant was not recorded, although evidence suggests that DITR was aware of the doubtful circumstances surrounding the applicant's previous business which had been liquidated. Approximately 8 months after receiving the loan, the firm went into receivership. The receiver/manager advised DITR to write-off the loan as a bad debt, and indicated that there were certain irregularities arising from the company's operations.

Management response by DITR

Financial statements of the company for 3 financial years were obtained. The loan was provided only after the provision of $120 000 from the Department of Defence towards the development of a rough terrain vehicle.

2.5.25 By not conducting credit checks and reviewing an applicant's prior business history, DITR is not taking all reasonable measures necessary to be assured that applicants can successfully undertake projects and that the risk associated with the repayment of public moneys is minimised.

Management response by DITR

DITR advised that it now carries out financial checks on all applicants and assesses the management capabilities and future prospects of companies seeking assistance. Firms are now required to submit business plans in conjunction with loan applications. These processes are being strengthened by the adoption of policy and procedure manuals within DITR.

APPROVAL OF LOANS BY TREASURER

2.5.26 Section 13 of the *Economic Development Act* 1981 states *inter alia* that the Minister: *"... may make payments or, with the approval of the Treasurer of Victoria, loans from moneys appropriated by Parliament for the purposes of the economic development of the State".*

2.5.27 Audit's interpretation of this section is that the Treasurer's approval should be sought prior to the Minister approving the issue of loans, in order that the Treasurer has a power of veto should he consider the granting of certain loans to be inappropriate.

2.5.28 Up until June 1985 the Minister obtained approval from the Treasurer for each loan prior to it being issued. Since that date a process was adopted whereby the Treasurer granted DITR a *blanket approval* to issue loans subject to moneys being available within budgetary restraints and the provision of quarterly reports to the Treasurer detailing loans provided.

2.5.29 Audit raised with DITR that while the above process may improve administrative efficiency, in audit opinion, it may also be contrary to the intention of the Act in that loans were in effect approved after loan advances had been made. Audit was also of the view that the legislation did not provide the delegation to the Minister to approve loans.

2.5.30 Subsequent to the matter being raised by audit, DITR obtained a legal opinion from the Solicitor-General which in essence stated:

> *"The Treasurer has laid down guidelines in accordance with which loans are to be made and said that he approves of loans made in accordance with those guidelines. If loans are made in accordance with those guidelines then in my opinion the loans are made with the approval of the Treasurer. It is not necessary for the Treasurer to examine the specific terms of each loan before the money is handed over.*
>
> *"It is not right for the Auditor-General to say that the Treasurer approved loans after the loan advances had been made. In all cases the Treasurer approved of the loans before the loan advances were made. However, the approval was general and not specific. Section 13(3) does not say that the Treasurer should exercise his discretion in such a way that he will have a power of veto in respect of each particular loan. What the section says is that loans shall be made with the approval of the Treasurer. In considering those words we have to remember that the power to grant the loans is the obligation of a Minister other than the Treasurer. It is my opinion (in those circumstances) that a general approval is clearly within the meaning of the expression in section 13(3) leaving the detailed application of the Treasurer's guidelines to the responsible Minister".*

Management response by DITR

The current administrative arrangements to facilitate the Treasurer's approval of loans were made after extensive consultation between DITR and the Department of Management and Budget in 1985.

A legal opinion obtained by DITR from the Solicitor-General provided the view that if loans are approved in accordance with guidelines laid down by the Treasurer, the loans were made with the approval of the Treasurer.

Furthermore, section 13(3) of the Act was introduced by the present government which would be more aware of the intent of this than audit. Audit has reached this conclusion without the benefit of any written legal advice whereas DITR confirmed this position from 2 sources.

DEFICIENCIES IN LOAN AGREEMENTS

2.5.31 The Minister for Industry, Technology and Resources signed most loan agreements with exceptions relating to lesser amounts for which agreements were signed by officers under delegation by the Minister.

2.5.32 An internal review conducted by DITR during 1987 identified certain deficiencies in loan agreements, mainly in relation to poorly drafted terms and conditions, absence of standard formats, and a lack of communication between case officers and DITR's Legal Section. Recommendations arising from the internal review resulted in a revision of procedures and increased liaison with legal officers. However, while improvement has resulted, certain problems still remain as a result of past actions and continuing deficiencies with existing processes as outlined below.

Absence of formal agreements

2.5.33 Isolated instances were found where formal loan agreements had not been entered into, with loan arrangements being negotiated mainly on the basis of an exchange of letters. As a consequence, the ability to enforce loan recovery in the event of default became doubtful, particularly in those instances identified where stamp duty had not been paid and accordingly the agreements were not legally binding between parties. An example is set out below:

Australian Wildlife Reproductions

A formal loan agreement was not entered into in respect of a loan made to the company. When the loan became due for repayment in 1987 the company was experiencing liquidity problems and applied to the Minister to extend the period of the loan.

DITR considered taking legal action to recover the loan, but was advised by its legal officer that due to the absence of a formal agreement:

- It would be necessary to prove the existence of a legal agreement in a court of law. Evidence to this effect would most likely be required from the Minister and the case officer and would involve proving the existence of negotiations and acceptance by the company of an offer from the Minister; and
- Any agreement made was not legally enforceable as stamp duty had not been paid.

After consideration of this advice DITR had little alternative but to re-negotiate the terms of repayment some 6 months after the loan recovery date fell due.

Management response by DITR

Although DITR acknowledges it would have been preferable to have completed a formal agreement, it holds the view that the exchange of letters between the firm and DITR represented a legally enforceable agreement. The loan was re-negotiated in April 1987 following growth in the firm which necessitated re-financing of the loan. A formal agreement on this occasion was prepared and signed.

Procedures requiring that all loans be supported by formal agreements were introduced in mid-1988 in conjunction with improved procedures.

All agreements are now taken by hand to the Stamp Duty Office, duty paid and agreements stamped before moneys are paid under the loan agreement.

This company has met all repayments due under the re-negotiated agreement up to the present time.

Poor terminology in loan agreements

2.5.34 Legal terminology in loan agreements, particularly in relation to conditions and performance measurement criteria, was found to be vague, inadequate and ambiguous.

2.5.35 The use of vague terminology and not readily measurable performance criteria often resulted in firms receiving financial assistance not being required to provide information of sufficient detail to enable DITR to properly evaluate the success or failure of the provision of government assistance. In addition, the vagueness of certain agreements provided avenues for firms to spend loan moneys on projects other than those referred to in the original submissions to DITR for assistance.

2.5.36 Specific evidence of firms failing to broadly comply with proposals contained in original submissions was not sought by audit. Nevertheless, poorly drafted loan agreements had the potential to place the recovery of public loan moneys at risk should moneys be expended in a manner other than originally intended. Poorly drafted legal provisions also increased the potential for moneys to be expended in a manner that was not compatible with the Government's economic strategy.

2.5.37 In relation to performance measurement criteria, agreements contained wording such as: *"... the company should use its best endeavours to maintain ..."* and *"... the company should agree to provide suitable information as will attest to the effectiveness of the capital spending"*. In the absence of specific direction from DITR as to what information was required, it was considered by audit that the performance of companies could not be properly measured in terms of the stated legal requirements.

2.5.38 DITR needs to ensure that all loan agreements provide clear, concise and quantifiable terms, conditions and responsibilities of each party.

Management response by DITR

DITR agrees that all agreements should be clear, concise and have quantifiable terms. However, the nature and objectives of financial assistance provided are such, that it is not always possible to specify performance criteria which are absolutely measureable.

Furthermore, most of the loans over the period of the audit review were negotiated packages related to "phase-out" of "decentralisation assistance schemes", and it was neither possible nor practicable to negotiate performance criteria to the standard sought by audit - particularly with loans substituting for "as-of-right" entitlements to ongoing government subsidies.

As stated by the Premier on 15 March 1989, DITR will no longer provide loans to industry, only grants.

Provision of financial information

2.5.39 Loan agreements entered into by the Minister did not contain a requirement that firms provide copies of audited annual financial statements. It was also noted that departmental procedures on the provision of loan assistance did not provide guidance to staff on the financial reporting obligations of loan recipients.

2.5.40 Audit considered that the provision of the above information was essential for purposes of monitoring the financial stability of firms, assessing the effectiveness of assistance provided and identifying adverse trends which may ultimately impact on the ability of DITR to recover moneys advanced.

2.5.41 As a minimum, all loan agreements need to provide for the provision of annual audited financial statements. In conjunction with this requirement a system needs to be established to ensure that such information is received and properly monitored during the life of each loan.

2.5.42 In addition to the lack of provisions to request audited financial statements from firms, as referred to previously, some agreements did not contain any provisions for DITR to request basic monitoring information such as performance data, sales and production information etc.

2.5.43 The rights of DITR to monitor loans by requiring firms to regularly submit specified reports suitable for monitoring purposes should be clearly established in all agreements.

Management response by DITR

Audited accounts are a desirable condition for DITR financial support and would be sought for all loan assistance. Monitoring requirements will be addressed in the new standardised legal agreements.

Right of access by DITR

2.5.44 It was observed that loan agreements did not include provisions for departmental officers to have right of access to company documents, plant, buildings and other assets for the purpose of inspection and verification that loan moneys were being expended for purposes agreed upon with DITR. This aspect was also of importance where progress payments were made by DITR to firms, in order for it to be satisfied that payments were not issued in advance of requirements, thereby ensuring that interest was not being foregone on State funds.

2.5.45 The right of access should be incorporated in all loan agreements.

Loan recovery action

2.5.46 Loan agreements examined by audit did not specify conditions under which DITR could recall loans. The need to recall loans could arise in various circumstances including failure of firms to comply with terms and conditions of loan agreements, where a firm is being wound up or taken over, or where loan moneys have been expended in an unauthorised manner.

2.5.47 The absence of clearly specified loan recovery provisions in loan agreements could eventuate in legal difficulties where the recall of loans is requested by DITR.

Management response by DITR

DITR's legal officer advised there was a common law right to sue if loan moneys were used inappropriately. However, access provisions in conjunction with monitoring requirements and debt recovery provisions will be addressed in new standardised legal agreements.

SECURITY FOR LOANS

2.5.48 DITR did not take security for any of its loans. Its rationale was that in assisting firms with limited access to traditional sources of finance the taking of security on loans could limit the future borrowing capacity of firms.

2.5.49 While it was not government policy to seek security on interest-free loans provided in lieu of decentralisation benefits, this should not have prevented DITR from actively seeking security, where practical, for other loans in the interests of safeguarding the public funds involved.

2.5.50 Evidence was available, however, to suggest that on a number of occasions loan applicants expected and were prepared to provide security on loans. An example is set out below:

Nangiloc Colignan Farms

The report of a consulting firm engaged by Nangiloc Colignan Farms to assist it with funding arrangements noted that the farm had been valued at $2.8 million as compared with a book value of $687 000. The report further stated that: *"... if security were required deferred ranking security over business assets might be sufficient, or even simply a personal guarantee from the loan applicant".* DITR granted the firm a loan of $100 000 in April 1986 but there was no evidence to indicate that the security available was sought.

2.5.51 It was recommended that the availability of security (either in full or in part) be investigated in each instance as part of the loan evaluation process.

Management response by DITR

The availability of security either in full or part is normally considered in each instance as part of the loan evaluation process. However, due regard must be given to a firm's growth opportunities and the taking of security by DITR should not limit a firm's ability to obtain secured funds from the private sector for growth needs.

MONITORING OF LOANS

2.5.52 Most loan agreements examined by audit contained a range of terms and conditions to be met by firms obtaining financial assistance from DITR. These terms and conditions, which were often broadly worded, included the following:

- Evidence to be provided to the Minister, usually within specified time constraints, of progress by the firm in reaching established goals;
- Loan proceeds to be expended on the purchase of specified assets;
- Once a loan was accepted from DITR the firm was normally required to forego all other types of departmental assistance; and
- Firms required to maintain specified employment levels during the term of the loan and to provide DITR with reports thereon. Penalty interest on loans to be paid if agreed employment levels not met.

Failure to monitor conditions

2.5.53 Examination of a selection of loan files disclosed that in many instances DITR had failed to:

- **adequately review and verify information provided by firms in accordance with loan conditions;**
- **conduct physical inspections where warranted;**
- **monitor the receipt of reports required from companies pursuant to loan conditions; and**
- **establish satisfactory monitoring procedures to ensure loan terms and conditions were adhered to by firms.**

2.5.54 Specific examples of inadequate monitoring of loan performance included the following:

F.J. Trousers Pty Ltd

A loan agreement for $2.5 million with the firm required it to sustain total employment levels of 750 full-time employees for the next 10 years at its Warrnambool and Brunswick plants and at any other factories opened in Victoria. Although the loan was interest-free, penalty interest was payable on loan advances if these employment levels were not maintained.

In support of the loan application the firm advised DITR that at the time of the application employment levels at plants in Warrnambool and Brunswick stood at 770 employees. In fact, payroll tax and other information already held by DITR indicated that 773 employees alone were employed at Warrnambool, with an estimated 350 employees at the Brunswick plant. In audit opinion, the agreement inadvertently allowed for the reduction of employment levels by up to 33 per cent without the prospect of penalty interest being incurred by the firm.

Audit considered that as a minimum DITR should have verified the firm's employment levels prior to approving the loan by:

- **checking employment levels against the payroll tax rebate file maintained by DITR's Finance Branch; and**
- **conducting an examination of the firm's payroll records.**

Management response by DITR

The employment levels have been interpreted by both the client and DITR as referring to production personnel only. In fact, the agreement states that the 750 persons obligation relates to employment in factories and plants, not all establishments of the company in the State. This is consistent with the Government's emphasis on manufacturing.

In the case of Warrnambool, there were also employees engaged in cleaning, gardening, stock control and handling, canteen services, corporate executive office and administration, computer services, credit co-operative, mail order and printing. These service classifications did not relate to the loan condition. Documentary evidence confirming employment numbers has been provided by the company and this was made available to audit.

Further audit comment

File documentation contained no reference to a distinction being made between production and non-production staff; nor was there any evidence of DITR seeking to independently confirm the employment levels quoted by the firm. Even after allowing for the exclusion of non-production staff, audit evidence indicated that prior to entering into the agreement there were significantly higher employment levels than those stated by the firm.

Australian Wildlife Reproductions

The firm was granted a loan for the purchase of new equipment and the training of operators. A physical inspection of the firm's factory was conducted by a departmental officer. The officer was shown various equipment which the firm indicated was purchased from the loan funds advanced. Invoices or other documentation to support the purchase of the equipment were not requested by, or produced for, the departmental representative.

Documentation which subsequently became available indicated to audit that the equipment had not been purchased by the firm, but was leased.

Management response by DITR

There was an expectation that new equipment would be purchased, new operators trained and some working capital provided from the loan. However, in specific terms, the letter of offer specified no particular application of the loan.

The company was required "... to provide such suitable information as will attest to the effectiveness of the capital spending". This comment clearly indicated the acquisition of new equipment. In terms of maximising the use to which the funds might be used, leasing of the equipment was not precluded.

Further audit comment

The firm's original application clearly specified a need for funds to purchase new equipment, the cost of which was detailed. The case officer's subsequent recommendation which was approved by the Minister referred to the purchase of new equipment. Based on this evidence, DITR's failure to specifically include in the letter of offer a reference to the purchase of new equipment can be regarded as an oversight. Notwithstanding this factor, subsequent representations from the company to DITR demonstrated an understanding that loan funds had been provided for the purchase of new equipment.

Garwood Limited

In June 1986 the firm was granted a loan of $700 000. The moneys were advanced on the basis of an initial instalment of $300 000 with the remainder to be paid in 4 equal instalments of $100 000 every 6 months, subject to the creation by the firm of a specified number of full-time jobs. If the firm was unable to create all these positions loan instalments were to be reduced on a pro-rata basis.

Following the receipt of the first progress report from the firm in which certain information was provided, DITR advanced the second instalment of $100 000. However, audit scrutiny of the information provided indicated that the firm had not met its employment creation obligations and, in accordance with the loan agreement conditions, the second instalment should have been reduced by $20 000.

Although DITR has recently obtained information from the firm which indicates that employment obligations were met, it was noted by audit that this **information was not sought until more than 12 months after the loan instalment in question was made.**

G. and H. Partos Pty Ltd

In January 1986, the firm obtained an interest-free, unsecured loan of $50 000 from DITR. The loan agreement provided for DITR to monitor employment levels in September of each year commencing in 1986, and for the firm to provide by 1 October 1986 evidence of the installation of a computerised stock control system.

The firm did not provide any of the above information, nor did DITR request it until December 1988. In the intervening period the firm was acquired by another company which subsequently was placed in receivership in March 1988. Although required by the loan agreement, ministerial approval was not requested in relation to assigning the loan liability to the acquiring company.

It now appears doubtful if the loan can be recovered by DITR. Had DITR monitored the financial position of the firm it would have become apparent at an early date that the firm was experiencing problems and action to recover the loan could have commenced.

2.5.55 DITR needs to improve monitoring procedures to ensure that:

- Information supplied by firms is independently verified, particularly where such information impacts upon eligibility for further assistance;
- Loan moneys are expended in the manner contained in agreements. Documentary evidence should be sought and supported by physical inspections, where warranted;
- The financial position of firms is monitored, particularly in situations where trading problems become apparent and are likely to impact upon loan recovery; and
- The effectiveness of providing assistance is evaluated.

Management response by DITR

Although DITR disputed certain audit evidence in relation to the examples quoted, it agreed with the need for increased resource allocation and attention to monitoring and evaluative activities. The new Financial Management Unit of DITR will be charged with explicitly monitoring the performance of loans.

Timing of advances

2.5.56 DITR's policy guidelines on industry assistance do not require the timing of advances to firms to match their need for funds. As a consequence, loan instalments were made in advance of funding requirements leading to:

- opportunities for firms to invest public funds in short-term, high risk investments; and
- interest being foregone by the State on funds otherwise available for investment.

2.5.57 An illustration of this issue is set out below:

Murray-Goulburn Co-operative Ltd

The firm initially requested that a $4.9 million interest-free loan provided by DITR in lieu of decentralisation benefits be made in 2 instalments. The first instalment was requested to be made between March and September 1986, and the second instalment to be made between March and September 1987. The firm subsequently indicated that the project would be undertaken earlier than anticipated and as a consequence DITR entered into an agreement whereby the first instalment was to be made in June 1986 and the second instalment in December 1986.

Following receipt of the first instalment, the firm submitted an expenditure timetable that disclosed that the project was not as far advanced as anticipated and would not be completed until March 1988. DITR paid the second instalment in January 1987, but on a needs basis this instalment could have been withheld until early 1988. It was also apparent that the first instalment was paid in advance of funding requirements.

Although DITR advanced the loan instalments in accordance with the terms of the loan agreement, it was noted that the agreement did not contain conditions for instalments to be paid on a needs basis, nor did DITR attempt to negotiate on deferring the second instalment. As a consequence, potential investment interest of at least $200 000 has been foregone by the State.

2.5.58 When issuing loans, DITR needs to ensure that the State's cash management position is optimised and advances coincide with demonstrated funding needs of firms.

Management response by DITR

DITR drew attention to the practical problems encountered by firms in predicting exactly when funds are required. However, the revised Procedures Manual will address this issue and ensure that the timing of advances are structured efficiently for both government and recipient.

2.5.59 Departmental policy guidelines on the provision of industry assistance loans state that: *"... we would expect that any financial support which we may contribute should be repaid together with a sensible rate of interest at some future date"*. The guidelines did not specifically define what was considered to be a *sensible rate of interest*.

2.5.60 In audit opinion the rate of return on interest-bearing loans was inadequate, mainly as a result of the following practices occurring:

- Instances of loans being interest-free for the first 1 to 2 years of the loan term;
- Although interest charged on certain loans was comparable to commercial rates, the interest payments were capitalised and became repayable at loan expiry date. This process reduced the return to DITR as interest was foregone on revenue which would otherwise have been received annually; and
- Instances of low interest rates being applied.

2.5.61 Audit was also concerned that the capitalisation of interest on loans increased the risk associated with recovering large amounts at the expiration of the loan term.

2.5.62 DITR needs to have action plans in place for achieving an acceptable rate of return on public funds, consistent with its stated policy.

Management response by DITR

The audit view reflects a basic lack of understanding that there is a "subsidy" inherent in "industry assistance" payments in DITR's programs.

Case officers keep in mind the desirability of obtaining a commercial return on financial assistance, but such a return is only a desirable outcome, not a policy obligation. The primary objective for case officers is the successful pursuit of commercial opportunities by individual firms which are judged to be of wider benefit to the State. One method of assisting in that process is the provision of financial assistance which encourages the full commitment of the borrowers in pursuing their opportunities.

In some circumstances, prevailing commercial interest rates and cash flow demands may be a significant barrier to a growth opportunity, necessitating some lesser rate of interest to encourage a decision to proceed.

As the Government has stated that DITR will not lend in the future, financial assistance will be through grants which will be without a commercial interest rate.

2.5.63 As part of their obligations in regard to public accountability, departments are required to table an annual report in Parliament, including a report on operations and audited financial statements pursuant to the *Annual Reporting Act* 1983.

2.5.64 In audit view, financial information provided should be sufficiently detailed to enable informed judgements to be made about a department's financial status and performance. However, the 1987-88 financial statements of DITR did not provide adequate details of expenditure of $54 million reported under the broad classification of "incentive and other development payments, loans and other assistance and expenses in connection with the development of industry".

2.5.65 Audit concluded that the financial information systems of DITR were inadequate and not conducive towards producing relevant information on a timely basis. A request by audit as to the composition of an amount of $16.9 million broadly described as "financial assistance packages etc." in DITR's 1987-88 program documentation was unable to be satisfied until 2 months after the date of the request. In relation to 1988-89 program information a number of categories of industry assistance expenditure could not be readily reconciled to financial records. It was also noted that certain expenditure was incorrectly classified.

2.5.66 In addition to the deficiencies in recording information, audit is of the view that DITR's annual financial statements and notes thereto do not provide adequate disclosure of DITR's activities. Information, which could reasonably be expected to be disclosed in financial statements of lending authorities would include:

- A distinction made between capital and interest in respect of loan debtors;
- Loans categorised into maturity dates, e.g. groupings of loans falling due with one year, 2-5 years, 6-10 years etc.;
- A listing of loans which do not have to be repaid if a firm is able to fulfil certain conditions, e.g. creation of a specified number of jobs;
- Details of loan agreements entered into at 30 June, but for which all advances had not been made; and
- Disclosure of bad and doubtful debts. During 1987-88 a loan of $100 000 made to a firm was written off as a bad debt but was not disclosed in DITR's *Annual Report*.

2.5.67 Although DITR prepares its financial statements in accordance with the Annual Reporting (Administrative Units) Regulations 1988, it is considered that in view of DITR's role as a lending body the minimum information required to be disclosed pursuant to these regulations does not provide adequate disclosure to Parliament.

2.5.68 It was recommended that the Treasurer initiate a review of reporting legislation to ensure that adequate disclosure is provided in departmental financial statements.

Management response by DITR

Changes will be made to the financial recording and reporting systems of DITR. More details will be provided on the structure and composition of programs. In future years Parliament will be provided with information on bad and doubtful debts.

2.6

VICTORIAN INVESTMENT CORPORATION LIMITED

2.6.1 The Victorian Investment Corporation Limited (VIC Ltd) has been used by the Government as a vehicle to acquire equity positions in companies, particularly those involved in technology-based business ventures. Prior to 1987, VIC Ltd was a wholly-owned subsidiary of the Victorian Economic Development Corporation (VEDC) and its audited accounts were included in the VEDC's *Annual Report* to Parliament. While the accounts of VIC Ltd were audited by a private auditing firm, they were available for scrutiny by my officers during the audit of the accounts of the parent body, the VEDC.

2.6.2 During 1987, the State acquired a majority shareholding in VIC Ltd. A consequence of this acquisition is that since 1987, the financial operations of VIC Ltd were no longer available for scrutiny by my officers; there was no requirement for VIC Ltd to table its *Annual Report* in Parliament and in line with current practice, the financial operations of VIC Ltd are not incorporated in the *Treasurer's Statement*.

2.6.3 The financial statements at 30 June 1988, provided to audit by the Department of Management and Budget, disclosed that VIC Ltd had acquired a controlling interest in 7 companies and a minority interest in 13 companies valued in total at $39.3 million. It had also provided loans to companies totalling $14.7 million.

2.6.4 Operating results of VIC Ltd for the past 3 years were:

1985-86	:	Profit	$44 000
1986-87	:	Profit	$22 000
1987-88	:	Loss	$8 227 000

2.6.5 The operating loss of $8.2 million in 1987-88 was arrived at after allowing for a diminution in the value of investments in other companies of $7 million. The notes to the financial statements also indicate that it may be necessary, depending on negotiations, to provide in the future, a further amount of $7 million in respect of the possible diminution in the value of its investments.

2.6.6 VIC Ltd holds 80 per cent of the issued capital of O'Dowd Research Pty Ltd, however, that company's accounts were not consolidated into the VIC Ltd group accounts as audited financial statements were not available. It is understood that VIC Ltd had also lent O'Dowd Research Pty Ltd an amount of $3.2 million. In November 1988 VIC Ltd applied to have the company wound up for failing to repay the $3.2 million and a winding up order was made by the Supreme Court in December 1988.

2.6.7 Prior to 1 December 1988, the VEDC held $2 million of the share capital of VIC Ltd. Under the direction issued by the Treasurer on 1 November 1988, this investment was not transferred to the Rural Finance Corporation. At the request of the Treasurer dated 1 December 1988 the shares have been transferred to the State at par value. In addition to the State being the sole shareholder, the Treasurer has issued a guarantee for $30.3 million over borrowings by VIC Ltd.

2.6.8 At 30 June 1988, taxpayers' funds committed to VIC Ltd were $55.8 million comprising an equity holding of $25.5 million and the guarantee over the companies' borrowings of $30.3 million. The deteriorating operating result of VIC Ltd over the last 12 months is of concern, but given the fact that I am not the appointed auditor, I am unable to offer further comment to the Parliament.

2.6.9 I note, however, that in the Ministerial Statement of 15 March 1989 the Premier advised that the Government intends to move out of the general venture capital area and will end its involvement in VIC Ltd.

2.7

VICTORIAN ECONOMIC DEVELOPMENT CORPORATION

This section of the report contains comments relating to :

- Growth in operations;
- Financial performance;
- Corporate management;
- Lending operations;
- Other forms of assistance; and
- Response to issues raised.

ROLE IN FINANCIAL MARKET

2.7.1 In general terms, the objective of the Victorian Economic Development Corporation (VEDC) was to play an important role in the development of a more efficient and competitive economy in Victoria. This was to be achieved by the provision of financial assistance, either by loan and/or equity participation, to business ventures with growth potential in the areas of:

- production of goods and services in Victoria, in particular those which were produced for the export market, or to be competitive against imports;
- tourism;
- providing employment opportunities in Victoria; and
- the development of economic activity in country areas.

2.7.2 The Government, in its economic strategy, perceived that the businesses which would seek assistance from the VEDC would largely comprise those which, in finding finance to assist in their development, would not be able to provide the level of security traditionally sought by the trading banks or be able to afford the interest rates sought by finance companies.

2.7.3 However, the VEDC went far beyond just filling the gap envisaged by the economic strategy and became an active participant in the finance market, actually competing for business with financial institutions.

2.7.4 The VEDC's 1985-86 *Annual Report* reflected this policy change and indicated it provided: *"... development funds as a lender of first resort at commercial yet attractive interest rates and with a lesser concern for security".*

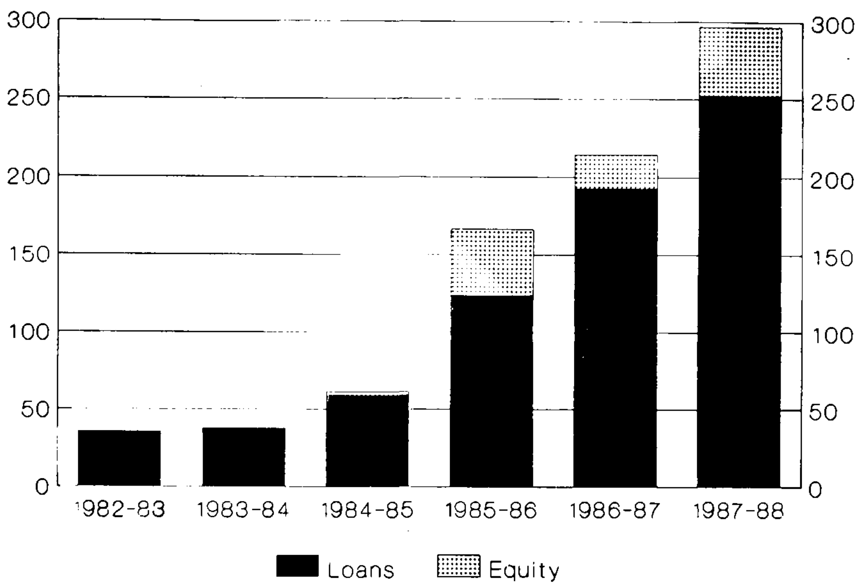
2.7.5 The Government's economic strategy identified an expanded role for the VEDC which led to a rapid increase in its activities through the provision of:

- financial assistance by way of loan or equity participation;
- leasing finance through its wholly-owned subsidiary VEDC Leasing Pty Ltd; and
- indirect assistance by way of guarantor.

2.7.6 The expanded role of the VEDC under the Government's economic strategy was reflected in the increased level of net assistance provided to companies. During the 3 year period ended 30 June 1988, $235.7 million was provided compared with $61.4 million during the 3 year period ended 30 June 1985.

2.7.7 The growth of operations in terms of total net investments by way of loans and equity over the period 1982-83 to 1987-88 is set out in Chart 2.7A below:

CHART 2.7A.
NET INVESTMENTS IN LOANS AND EQUITY, AT 30 JUNE
($ million)



OPEN-ENDED BORROWING

2.7.8 In order to finance its activities, the VEDC obtained funding mainly by way of borrowings. These were obtained principally from the Victorian Public Authorities Finance Agency and at 30 June 1988 totalled $276.6 million.

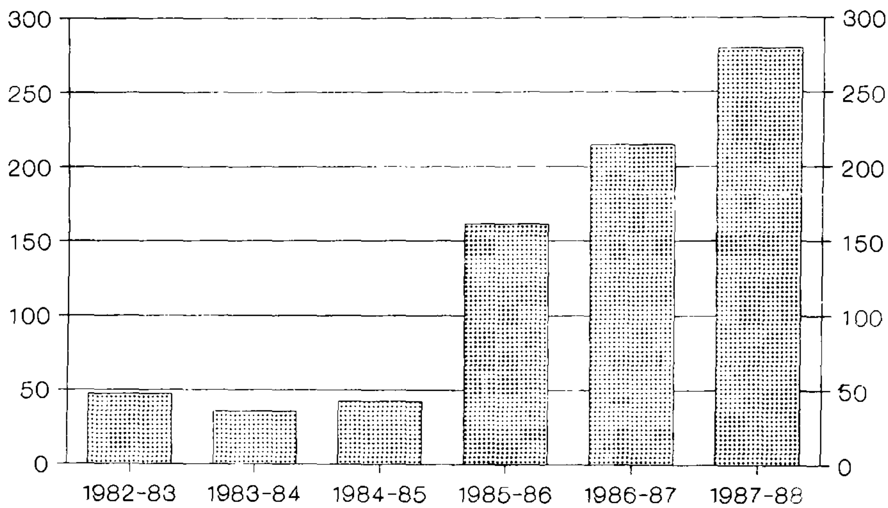
2.7.9 Prior to 1985-86, the VEDC's borrowings were limited to the amount approved by the Loan Council as part of Victoria's allocation. As from 1985-86 the borrowing limit set by the Loan Council did not apply to government-owned financial institutions such as the VEDC. **As a consequence the VEDC had an open-ended borrowing facility available to finance its activities.**

2.7.10 This open-ended borrowing facility contributed to a dramatic increase in its future liabilities and brought with it a further element of risk into what was already a high risk environment.

2.7.11 However, in 1987-88 the Treasurer of Victoria approved all individual borrowings made by the VEDC, but failed to set an annual borrowing limit, although the *Victorian Economic Development Corporation Act* 1981 provided for such a limit to be established.

2.7.12 The increase in the total liability for borrowings over the past 6 years is illustrated in Chart 2.7B below:

CHART 2.7B.
TOTAL LIABILITY FOR BORROWINGS, AT 30 JUNE
($ million)



IMPACT ON LENDING

2.7.13 As the VEDC had access to open-ended borrowing, the level of funding it had available for loans was effectively unrestricted. Coupled with this was the perception that if the VEDC was not seen to be taking risks it was unlikely to be achieving its objective as stated in its annual report of providing "development funds as a lender of first resort".

2.7.14 The audit review indicated that the evaluation by the VEDC of applications for assistance occurred without adequate consideration being given to the:

- **achievement of the objectives of the Government's economic strategy; and**
- **capacity of companies to repay loans.**

2.7.15 The VEDC was no longer filling the gap envisaged by the economic strategy but had become an active participant in the finance market. This was illustrated in the following case.

Nicholas M. Laurence (Australia) Pty Ltd

The company sought finance to acquire a cheese plant for $1.8 million. The company requested finance from the VEDC of $475 000 with the balance of the purchase price to be financed by bank loan. The VEDC's lending officer evaluating the application recommended a loan to a maximum of only $300 000, given the company's inadequate capital base.

In an internal memorandum from the lending officer to the Board on 16 September 1986, it was stated that: *"... in the event that one of the trading banks was prepared to assist but at an interest rate comparable or higher than VEDC then we would be prepared to provide up to $1.2 million"*.

Subsequently, a bank offered to provide $1.6 million to the company, however, due to the interest rate equating to approximately 20 per cent, which was higher than the VEDC rate of 17.5 per cent, the VEDC then decided to fully fund the acquisition and provided a loan of $1.8 million.

2.7.16 In addition, the review found that a number of other companies were provided with funds by the VEDC without the companies having first sought funds from traditional sources.

2.7.17 In audit opinion, the activities of the VEDC had evolved to the situation where the injection of funds into the economy had become one of its primary objectives, this being facilitated by its unrestricted access to borrowings which had the sanction of the Treasurer prior to 1987-88.

GROWTH INADEQUATELY RESOURCED

2.7.18 The VEDC, like any conventional financier whose source of funds was principally from borrowings, should have been capable of meeting its operating costs, including the cost of employing staff, from profits. In general terms profits should have been generated from the difference between the lending and borrowing rates of interest, i.e. the interest margin. However, the VEDC's interest margin was eroded due to the substantial increase in the number of non-performing loans, the provision of interest-free loans and the conversion of loans to equity. Table 2.7C illustrates how the interest margin has been eroded notwithstanding the substantial increase in lending activities over the past 3 years:

TABLE 2.7C. INTEREST RECEIVABLE/PAYABLE

($ million)

Item	*1984-85*	*1985-86*	*1986-87*	*1987-88*
Interest receivable	11.4	15.0	27.2	33.1
Interest payable	7.9	12.1	25.3	35.4
Gain/(loss)	3.5	2.9	1.9	(2.3)
Interest not raised*(a)*	-	1.3	3.7	16.8

(a) Represents interest due from borrowers in default of their repayment obligations which was regarded by the VEDC as unlikely to be collected. In accordance with generally accepted practice in the finance industry this interest had not been taken into account in determining the operating result for the year.

2.7.19 The expansion in the VEDC's activities was not supported with an adequate managerial and administrative structure nor was it accompanied by an appropriate adjustment in the number of staff directly involved in managing the loan portfolio. The failure to employ additional staff was a factor which contributed to the decline in the quality of the assessment and monitoring process.

2.7.20 The *Fergus Ryan Report* points out that the VEDC had been under-resourced in terms of personnel, that staff training was inadequate, job descriptions did not exist and there was no evaluation procedure of consequence in place.

2.7.21 Although it is the prerogative of the Government to expand the role of any of its organisations, it is the responsibility of the executive management of the organisation affected to ensure that there are adequate resources to carry out the expanded role or to inform government of the likely effects if such resources cannot be obtained.

VEDC INSOLVENT

2.7.22 The VEDC suffered a dramatic downturn in its result for the year ended 30 June 1988, incurring a loss of $105 million (1987, $1.9 million profit).

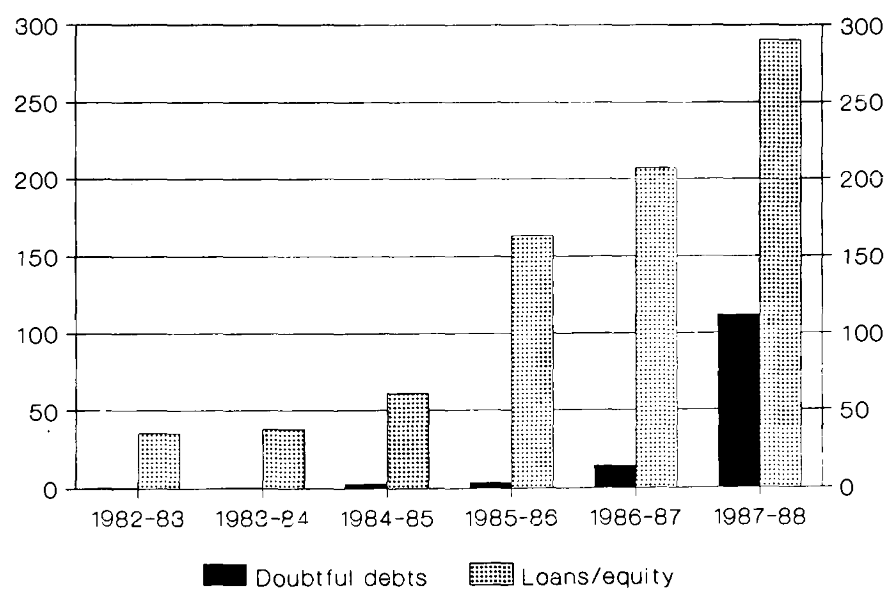
2.7.23 An analysis of the VEDC's financial position at 30 June 1988 indicated that the VEDC was insolvent. At that date, the State's equity contribution of $32.6 million was the extent of funding provided to the VEDC. As the repayment of borrowings by the VEDC is guaranteed by the State, a further $72.4 million may be required from the public purse to meet potential shortfalls in the future.

DOUBTS SURROUNDING THE RECOVERY OF LOANS

2.7.24 The downturn in the financial position had arisen due to the doubt which surrounded the future recovery of loans provided by the VEDC. This has been reflected in the increase in the provision for doubtful debts from $13.9 million in 1987 to $111.7 million at 30 June 1988, i.e. the recovery of 36 per cent of the total value of loan advances including accrued interest and equity investments was considered doubtful at 30 June 1988 compared with only 6.3 per cent a year earlier.

2.7.25 Actual losses in respect of loans provided, i.e. the loan has been written off, was $2.4 million in 1987-88. However, official receivers and managers have been appointed in companies with outstanding loans totalling $56.9 million. The significant increase in the doubtful debt compared with the VEDC's lending activity at 30 June for the years 1982-83 to 1987-88 is illustrated in Chart 2.7D below:

CHART 2.7D.
LOANS/EQUITY AND DOUBTFUL DEBTS, AT 30 JUNE
($ million)



INFORMATION ON DOUBTFUL DEBTS

2.7.26 It was normal procedure for a representative from DITR to attend VEDC Board meetings and to report on that meeting to the Minister.

2.7.27 In March 1988, the General Manager submitted to the Board a projected balance sheet at 30 June 1988 which was described in the report as a "realistic" provision for doubtful debts of $27.1 million. Also provided was a listing of non-performing loans, amounting to $21.6 million, for which the potential loss could not at that time be assessed and a listing of loans, amounting to $54.9 million which were being closely monitored. These latter loans were described as being major exposures where a significant loss could be incurred but no increase in the provision for doubtful debts was seen as being warranted at that stage.

2.7.28 Subsequent reports to the Board of non-performing loans showed that the estimated provision for doubtful debts had increased over the period to $40.3 million as at 30 September 1988. This estimate did not include any provision for the writedown of equity investments. The reports to the Board, while listing non-performing loans for which a specific provision had not been made, did not provide details of loans requiring close monitoring.

2.7.29 It was not until a detailed review of the loan and equity portfolio was undertaken in November and December 1988 that the Board determined that the provision for doubtful debts to be included in the financial statements for the year ended 30 June 1988 was $111.7 million.

POSITION AT DATE OF TRANSFER

2.7.30 By direction of the Treasurer, given under the provisions of the *Rural Finance Act* 1988, certain assets and the liabilities of the VEDC were to be transferred to the Rural Finance Corporation (RFC) on 30 November 1988. The Treasurer directed that the VEDC was to retain its investment in Wallace International Limited. The investment in the Victorian Investment Corporation Limited was to be sold at original cost to the State.

2.7.31 The unaudited financial statements of the VEDC at the date of transfer to the RFC disclosed a further operating loss of $6.4 million.

2.7.32 Table 2.7E illustrates the assistance provided by the VEDC at 30 November 1988 and the portion considered by management to be doubtful as to recovery:

TABLE 2.7E. ASSISTANCE PROVIDED BY VEDC

Item	*$ million*	*Percentage*
Loans	258.0	87.3
Equity	37.5	12.7
	295.5	100.0
Considered doubtful	111.7	37.8
Likely to be recovered	183.8	62.2

2.7.33 In addition to the above assistance, the VEDC in its capacity to act as guarantor had a contingent liability of $6.1 million for guarantees.

2.7.34 In the past, audit has expressed concern over the increasing level of non-performing loans and the poor performance of certain companies in which the VEDC held equity investments. The related causes, such as inadequacies in loan procedures covering applications, approvals, evaluation and monitoring procedures, had been drawn to the attention of representatives from central agencies and the VEDC at the completion of the audit in December 1987 in order that immediate corrective action could be instigated. Formal reports detailing audit concerns were forwarded to the Treasurer, the Minister for Industry, Technology and Resources, and the VEDC in March 1988 and comment was included in my report to Parliament in April 1988.

DIVIDEND PAYMENT

2.7.35 The policies set out in the VEDC's 1986-87 *Annual Report* stated in part that: *"... the operations are run on a commercial basis and are expected to make sufficient profit to meet the payment of dividends and the creation of adequate reserves"*.

2.7.36 When originally established, the State Government provided the VEDC with funding by way of an equity contribution of $2 million. Expansion of the VEDC's role in line with the Government's economic strategy brought with it a requirement to increase its capital base. This increase was achieved by conversion in 1984 and 1986 of State loans to equity so that the total equity at 30 June 1988 was $32.6 million.

2.7.37 The State required that, if it so determined, the VEDC would pay to the Consolidated Fund an amount based on interest foregone by the State on the loans converted to equity. This arrangement is not backed by legislative authority.

2.7.38 Dividend payments compared with the operating result in the past 3 financial years are detailed in Table 2.7F below:

TABLE 2.7F. DIVIDEND PAYMENTS BY VEDC

Year	*Operating profit (loss)*	*Dividend paid*	*Return to State*
	($ million)	($ million)	(per cent)
1985-86	0.5	1.2	3.7
1986-87	1.9	4.8	14.7
1987-88	(105.0)	Nil	Nil

2.7.39 The Treasurer determined the 1986-87 dividend payment prior to 30 June 1987 whereas the operating result for the year did not become known until 16 October 1987. The determination of the dividend of $4.8 million coincided with the sale of the VEDC's share of the Hong Kong Bank on 23 June 1987 and did not take account of the level of profitability required by the VEDC to meet its future operating needs. After payment of this dividend, the accumulated surplus was reduced to $139 000. The ability of the VEDC to meet its future obligations was further affected by the impact of the share market crash of 21 October 1987 on the companies to which it had lent funds.

2.7.40 The amount paid by the VEDC to the Consolidated Fund was not a dividend in the true commercial sense as it was not based on the VEDC's financial performance and its capacity to pay.

PERFORMANCE INDICATORS

Minister required to determine quantifiable targets

2.7.41 The *Victorian Economic Development Corporation Act* 1981 provided for the Minister for Industry, Technology and Resources in conjunction with the VEDC management, to determine annual quantifiable targets to be attained.

2.7.42 The VEDC published in its *Annual Reports* details of the composition of the quantifiable targets and the extent to which they had been achieved. The targets established for 1987-88 related to the proportion of assistance to be applied to preferred industries, small firms and country industry.

Inadequate targets

2.7.43 The targets established by the Minister in conjunction with the VEDC Board related to simple, quantitative measures. There was a striking absence of qualitative performance measures such as the extent to which loan and equity funds provided assisted in the:

- exporting of Victorian produced goods;
- production of goods and services in Victoria which resulted in a decrease in imported goods;
- provision of employment opportunities; and
- provision of tourist facilities.

2.7.44 Quantitative targets were seen as the sole or overwhelming challenge to the VEDC and therefore their achievement was identified as a direct measurement of effective performance.

2.7.45 VEDC loans officers were in fact provided with weekly loan targets. Therefore pressure existed to ensure that their target of loans was achieved. As a consequence the achievement of a performance target may have become the priority of loans officers rather than the prudent examination of all applications.

2.7.46 In audit's view the achievement of overall lending targets is considered relatively insignificant especially when compared with determining the beneficial effects on the Victorian economy of the funds advanced. Without qualitative indicators to measure the extent to which the key objectives of the economic strategy had been achieved at an agency level, both the Treasurer and the Department of Management and Budget were not provided with information to enable informed decisions on future directions to be made.

Lack of measurement systems

2.7.47 It would have been reasonable to expect the VEDC to implement information systems to measure the extent to which funds provided had been effective in achieving the objectives of the economic strategy. However, such systems were not developed by the VEDC. **It is therefore not possible, even after the loss of $105 million of public funds, to determine what beneficial effect these funds have had on the achievement of the economic strategy objectives of this State.**

ACTIVITIES OF THE BOARD

2.7.48 In audit opinion, some of the Board members did not always have the interest of the VEDC as a high priority. Examples of this are:

- A special meeting was called in March 1988 to discuss the deteriorating financial position of the VEDC. Only 5 of the 9 Board members attended this meeting. The Chairman expressed his disappointment with the absence of Board members in view of the seriousness of the matter being discussed; and
- A later meeting of the Board, in March 1988, was arranged with senior executives of a public company in order for the Board to gauge the level of support that company might be prepared to provide towards Garwood Limited, a company which at that date had obtained substantial assistance ($13.4 million) from the VEDC. The meeting was only attended by the Chairman and one Board member.

2.7.49 It was also noted that certain members were regularly absent from meetings.

2.7.50 The successful operation of any organisation is dependent on effective communication between the Board and management, so that Board directives can be put into operation and major strategic and operational problems can be directed to the Board for action. **Audit noted references in the Board minutes which indicated that management of the VEDC could not provide its Board with information on a timely basis.** The following are some examples:

- On 4 March 1988 the Board criticised management with regard to the length of time taken to produce reports requested by it, in particular, reports relating to the VEDC's non-performing loans; and
- The Board also expressed concern at a meeting in August 1988 that a report received from the Auditor-General on 24 March 1988, on non-performing loans and inadequacies in loan procedures, had not been distributed to members. It was also requested that the Board be provided with details of action taken by management in response to recommendations contained in the report.

2.7.51 Evidence also existed that the control exercised by the VEDC's Board had been circumvented. The following comments were contained in the Board's minutes of 19 February 1988 relating to Wallace International Ltd: *"Under no circumstances in the future will the VEDC Board tolerate another chain of events where they are presented with a fait accompli by management or any other factors associated therewith from outside sources and no decisions will be given by the VEDC Board without the full facts being placed before them prior to any event taking place".*

2.7.52 The Board at its meeting on 22 April 1988 found it necessary to pass the following resolution to ensure approvals for loans would not be given outside of Board meetings: *"...it will in future refuse to give telephone approvals for loan applications without full documentation being submitted to members for consideration".*

2.7.53 Further criticism levelled at the Board in the *Fergus Ryan Report* clearly indicated that many of the members of the Board did not have the necessary skills or qualifications for the effective management of a financial institution. **Audit also concluded that a number of Board members were less than diligent in discharging their obligations at a time when the financial position of the VEDC was deteriorating.**

EX-GRATIA PAYMENT TO GENERAL MANAGER

2.7.54 The audit review also indicated that there were serious deficiencies in the management of the VEDC's day-to-day activities which was the responsibility of the former General Manager, Mr Beattie, until April 1988.

2.7.55 The *Fergus Ryan Report* was also critical of the former General Manager's performance, particularly in his role in the sub-underwriting by the VEDC of the Wallace International Ltd share issue. The report stated: *"To have entered into such a commitment without the formal consent of the Board and the proper approval of the Minister was a flagrant breach of his authority and duty and in my judgement warranted dismissal".*

2.7.56 Mr Beattie's resignation in April 1988 came soon after the submission by him to the Board of a personal explanation of his involvement in the sub-underwriting agreement.

2.7.57 Notwithstanding his actions, the Board approved an ex-gratia payment of almost $36 500 to Mr Beattie.

2.7.58 I am surprised that the Board saw fit to approve an ex-gratia payment to Mr Beattie as he had effectively ceased his contract of employment with the Board by resigning. His involvement in the Wallace underwriting agreement could result in an eventual cost to the public purse of $15.25 million.

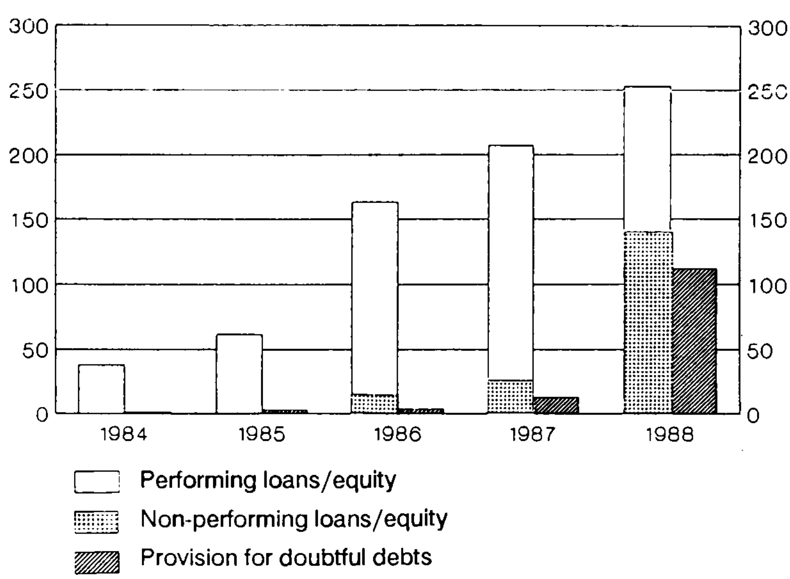
OVERVIEW

2.7.59 The Government's economic strategy statement *Victoria: The Next Step* had projected that: "*... the expansion of activities would occur without altering the VEDC's present criteria of prudent management and appraisal*".

2.7.60 However, the audit review disclosed that due to the inadequate management procedures at all levels within the VEDC, financial assistance was provided to businesses which had not adequately demonstrated, either at the time of original application or in trading results since, that they could repay the assistance provided. Further, a review of a sample of performing loans, i.e. those which were not in arrears in relation to payments of interest and repayment of loans, indicated that there was doubt that on their present financial position and projected trading forecasts they could continue, in the foreseeable future, to meet their repayment commitments.

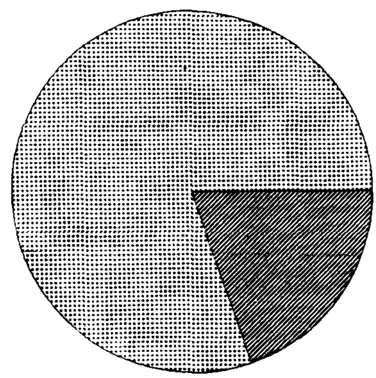
2.7.61 The following chart illustrates the break up of loans and equity between performing, non-performing and the related provision for doubtful debts for the past 5 financial years. The chart also highlights the significant increase in non-performing loans, of which in excess of $60 million was advanced in 1987-88, as well as a consequential increase in the provision for doubtful debts.

CHART 2.7G.
LOAN/EQUITY PORTFOLIO, AT 30 JUNE
($ million)



2.7.62 The above chart indicates that in monetary terms, 48 per cent of financial assistance provided was non-performing. However, on an individual company basis, 20 per cent of companies assisted had loans which were classified as non-performing, as illustrated in Chart 2.7H:

CHART 2.7H.
PERFORMING AND NON-PERFORMING LOANS, AT 30 NOVEMBER 1988
(Number of companies assisted)



2.7.63 While it has been acknowledged publicly by the Government and the VEDC that the nature of the finance provided, i.e. venture capital and development finance, involves more risks than would be acceptable to conventional financiers, one would have expected that there would have been a greater than normal emphasis placed on managing the risk.

2.7.64 Audit findings indicated that the opposite occurred and that inadequate management processes were the principal causes of the VEDC having to make the large provision for doubtful debts at 30 June 1988. These inadequacies are discussed below.

LACK OF COMPREHENSIVE POLICY FRAMEWORK

2.7.65 For a number of years the VEDC managed its loans using totally inadequate draft guidelines. Audit has previously drawn to the attention of the Board, that in its opinion, the guidelines were insufficiently detailed to enable applications to be assessed in a consistent manner.

2.7.66 Policy requirements not documented in the draft guidelines included major factors which required consideration in the evaluation of loan proposals.

2.7.67 The lack of comprehensive policy and guidelines, combined with the Government's intention that the VEDC operate on commercial lines, while taking more risk than would be acceptable to financial institutions, contributed to the inconsistent assessment of loan applications and business plans.

2.7.68 While recognising that all applications for financial assistance have their own unique circumstances, it is imperative that the management processes be consistent.

2.7.69 A comprehensive loans policy and procedure manual was eventually issued in October 1988, just one month before the operations of the VEDC were transferred to the RFC, but by then the damage had already been done.

INADEQUATE ASSESSMENT OF LOAN APPLICATIONS

2.7.70 The accurate assessment of an application for financial assistance is the most critical step in the loan management process as any error or misjudgement can result in a substantial financial loss to the lender. The assessment should aim to determine the degree of risk associated with lending to an applicant. The following points are relevant to the assessment process:

- expected benefits for the State;
- proposed cost of the project;
- proposed method of financing;
- extent of applicant's equity participation;
- applicant's financial position and stability;
- value and existence of security offered;
- past business performance;
- viability, accuracy and substantiation of the business plan;
- level of managerial expertise;
- credit worthiness; and
- ability to service debt.

Financial stability of applicants

2.7.71 Checks as to credit worthiness and financial stability of applicants are crucial in providing the lender with some measure of confidence regarding the eventual repayment of loans.

2.7.72 The review highlighted that in the majority of cases examined there was no evidence on file of credit checks being performed. Even where credit checks had been undertaken these checks could have been more extensive.

2.7.73 In other instances, reviews of credit worthiness revealed that applicants were experiencing liquidity and managerial problems but the VEDC did not always appreciate the need to assess the impact on the applicant's financial stability prior to approving loans. The following cases illustrate the lack of concern by the VEDC:

Mountain Holidays Pty Ltd

Prior to the provision of assistance to the company credit checks were conducted by the VEDC which revealed a number of instances where one of the applicant's associated companies had failed to make payments, necessitating court action. In addition, the previous 3 years' financial statements disclosed that the company was operating on bank overdrafts. The VEDC, however, provided a series of loans totalling $4.1 million over a period of 3 years.

An internal memorandum dated 10 October 1987 from a lending officer to the General Manager of the VEDC stated: *"... the borrower has never met any interest payment on the due date or within the permitted days of grace in the three years since the first loan was made. This was despite the fact that the Corporation consistently waived penalty interest of many thousands of dollars"*.

At 30 November 1988 the company's debt to the VEDC amounted to $4.1 million. Interest arrears had recently been paid from borrowing from another source. The company has placed its property on the market and the VEDC is expecting to recover all outstanding debts based upon recent valuations of the security.

Tusko Nominees Pty Ltd

In February 1984 a lending officer advised the Acting General Manager of the VEDC that:

> *"We are acutely aware from the financial position of the company and the lack of management ability of ... that on that basis the request for assistance could not be supported. Difficulties have been experienced by the Department of Industry, Commerce and Technology in relation to power supply to the site due to severe liquidity problems being experienced by the company.*
>
> *"However, we believe that there is some justification for endeavouring to assist in some way with the development of what could be the most valuable sand deposit in Victoria if not Australia with large potential overseas markets. In addition, it is considered that the venture could be run extremely profitably under proper management"*.

An initial loan of $988 000 was approved on 24 February 1984.

At 30 November 1988 the company's debt to the VEDC amounted to $5 million. The VEDC's loans to this company have been classified as non-performing.

Baruda Properties Pty Ltd

An internal memorandum dated 24 October 1988 from the lending officer to the General Manager (VEDC) included the following comment in respect of the Board fully financing the redevelopment project:

> *"The matter was considered by the Corporation's Board on 17 December 1986 when it had before it an application for $2 400 000 million to cover the cost of the project, i.e. the* total *funding was to be provided by the Corporation. By that time the borrower had established a nine year history of dealings with the Corporation marked by delays in project completion, considerable cost overruns, slow payments, frequent debt rescheduling, financial over-borrowing and lack of self funding etc.*

"To an outsider it may seem difficult to accept why any level within the Corporation would support the quantum leap involved in a loan of $2 400 000 - but in fact the loan was approved.

"The VEDC has put itself into a position of probable loss in this matter by its decision to provide a loan of $2.4 million - and by then providing a further loan of $1.4 million at a stage when it could have withdrawn and mitigated its downside risk exposure".

At 30 November 1988 the company's debt to the VEDC amounted to $4.3 million. The VEDC's loans to the company have been classified as non-performing.

Inadequate financial information

2.7.74 The provision of venture capital or development funds is in itself a risky business. To provide this type of assistance on decisions based on unsubstantiated information is taking risk to the extreme.

2.7.75 All applicants seeking financial assistance were required to provide details of their financial position. The financial information submitted to the VEDC consisted mainly of financial statements and cash flow forecasts.

2.7.76 The review revealed that the level of reliance that could be placed on the information provided by applicants was questionable due to the lack of substantiation by the VEDC of applicants' cash flow forecasts and financial information.

2.7.77 The failure to ensure that applicants' financial information was accurate and reliable led to incorrect assessments being made on the future cash flows and financial position of companies which has resulted in substantial losses to the VEDC. The implications to the VEDC of the decisions made on inadequate financial information are illustrated below:

Leetronics - Telmar Pty Ltd

Subsequent to a loan of $300 000 being granted to the company, an error in the 30 June 1987 unaudited financial statements was detected. The effect of the error was that accumulated losses had been understated by $129 833 as a result of creditors to that amount being omitted from the statement provided to the VEDC.

Had the statements been audited, the error would have been detected and the VEDC's decision in regards to the loan may have been different.

The company had been placed in receivership and at 30 November 1988 the company's debt to the VEDC amounted to $1.1 million.

Camperdown Meat Exporters Pty Ltd

The loan assessment in September 1987 considered the unaudited financial statements as at 30 June 1987 which indicated accumulated losses of $301 785. Up-to-date information was not sought by the VEDC to assist in arriving at a decision whether to provide finance. Later information received on 22 October 1987 indicated accumulated losses of $986 459 existed at 31 August 1987.

At 30 November 1988 the company's debt to the VEDC amounted to $2.5 million.

Color Offset (Aust) Pty Ltd

Funds were approved on the basis of a business plan which forecast a $305 000 profit (1987-88) and a 37 per cent increase in sales even though the forecast appeared very optimistic in view of the company's past performance. The actual result for 1987-88 was a loss of $561 000, with sales having decreased by 30 per cent.

At 30 November 1988 the company's debt to the VEDC amounted to $1.8 million.

Australian Vintage Travel Pty Ltd

The lending officer expressed the following concerns to the Board: "*The projections ... are certainly very, very, optimistic. To increase from $3.085 million turnover to $18.2 million in three years would be a remarkable achievement*".

Despite the above warning, the lending officer recommended that the Board approve a loan of $6.5 million. The officer stated: "*...whilst no independent assessment was undertaken we were satisfied with the budget for 1 year*".

Receivers/managers were appointed by the VEDC in July 1988. At 30 November 1988 the company's debt to the VEDC amounted to $15.7 million.

Inordinate sharing of risk

2.7.78 In a venture capital or development finance environment it is reasonable to expect that those seeking financial assistance from Government would be prepared to share the risk.

2.7.79 The review undertaken by audit showed that in a number of cases there had been very little by way of funds contributed by the owners of the businesses. Examples included:

Aussie Grape Pty Ltd

Audit noted that the loan facility of $700 000 was provided despite the Corporation's concern with respect to the company's financial position in that there was a lack of equity contributed by the owners for the venture.

Total equity by the owners ranged from $2 000 in June 1986 to $6 000 in May 1988. One of the reasons for the business being under-capitalised is that the owners each operate their own vineyard and have committed all their personal finances to the growing of table grapes and have had to finance the activities of the company using external funding.

At 30 November 1988 the company's debt to the VEDC amounted to $736 000.

Datatran Systems Pty Ltd

A loan for $1.2 million was approved in January 1986. Given the size of the loan audit considers the capital base of the company was minimal, namely undistributed profits of $6 600 and paid-up capital of $120.

At 30 November 1988 the company's debt to the VEDC amounted to $3.3 million.

Securities

2.7.80 The provision of some form of security minimises risk and exposure to loss of funds loaned. Assessment of securities generally necessitates title searches and obtaining or sighting valuations.

2.7.81 Varying forms of security were accepted by the VEDC against funds advanced. These included;

- registered mortgages over chattels and property;
- registered debenture charge over assets;
- joint and several guarantees; and
- letters of comfort.

2.7.82 Audit noted that on occasions loan applications were approved even though:

- tangible security could not be offered;
- securities were valued at less than the amount of funds advanced; and
- funds were advanced without confirmation of the value of the securities.

2.7.83 While the VEDC was not expected at all times to obtain the level of security traditionally sought by other finance companies due to the nature of its business, the VEDC's risk and exposure to loss increased due to inadequate security confirmations.

2.7.84 The following cases illustrate where security obtained by the VEDC did not adequately cover the loans advanced:

Wallace International Ltd

In May 1984 a loan of $1 million was approved by the VEDC to finance the purchase of factory premises, plant and equipment, and provide working capital. Security offered by the company, including the assets to be financed by the VEDC loan was assessed at only $810 000.

Later information received by the VEDC indicated that the loan funds had primarily been used for operational expenses, thus the VEDC's loan was essentially unsecured.

At 30 November 1988 the VEDC had an equity holding in this company which cost $15.3 million. Audit understands that legal action is pending to recover some of the equity investment.

Dimet Investments Pty Ltd

A loan of $3 million was approved to the company in July 1987 and the VEDC assessed security at $3.5 million. It was discovered later by the solicitors of the VEDC that securities thought to be held over the company in fact only related to a floating security charge over associated non-operating companies and excluded a charge over the assets of the company. The estimated value of securities held at 30 November 1988 was $1.5 million.

The company had been placed in receivership and at 30 November 1988 the company's debt to the VEDC amounted to $3.3 million.

LOAN APPROVALS

Ministerial approval

2.7.85 The relevant legislation required the Minister to approve all financial assistance provided by the VEDC except where the recipient was a rural or preferred industry or involved in the tourism industry. In all other instances, ministerial approval was required.

2.7.86 The major portion of the financial assistance provided by the VEDC did not require ministerial approval, however, internal arrangements between the Board and the Minister determined all financial assistance over $3 million was to be referred to the Minister for approval.

2.7.87 The audit review disclosed that the approval process did not always occur. For example, in July 1988 the VEDC wrote to the Minister seeking retrospective approval for financial assistance totalling $5.9 million. In granting the approval the Minister stressed that funds should not be advanced prior to approval being granted.

Board approvals not obtained

2.7.88 To ensure effective control over the VEDC's loan portfolio, it was essential that either direct or delegated Board approval was obtained prior to funds being advanced or variations made to financial assistance. Examples where approvals were not obtained included:

Braemar Ltd

The General Manager advised Braemar Ltd in December 1987 of the VEDC's "preparedness" to convert its $2.5 million loan to equity following the restructure of the company's operations.

This commitment was given prior to obtaining the required VEDC Board approval.

Baruda Properties Pty Ltd

Deferral of loan repayments was granted to the company on a number of occasions, but, there was no evidence on file to indicate that Board approval had been obtained.

Wallace International Ltd

The following 2 instances were noted:

- In October 1987 the Board approved a loan of $5.6 million, but later amended this approval to $2 million. However, funds of $4.5 million were subsequently advanced to the company. There was no evidence on file to indicate that Board approval had been obtained for the additional $2.5 million.
- The General Manager of the VEDC entered into a sub-underwriting agreement with Bain & Company Limited. The agreement is understood to have been executed on 6 November 1987. This was done without Board approval. This agreement was not ratified by the Board until 19 February 1988. Board minutes indicated that some Board members were unaware of the sub-underwriting agreement between the VEDC and Bain & Company Limited.

Board acting against advice

2.7.89 It was reasonable to assume that the VEDC Board would have taken into account the lending officer's recommendations regarding applications for financial assistance. Audit believes that where a loan was approved by the Board and such decision was contrary to the lending officer's recommendation, the reasons for granting the loan should have been documented by the Board.

2.7.90 Prior to the recommendations being presented to the Board, the lending officers were to ensure that proposals had been adequately assessed by appropriate internal investigations or by engaging consultants to perform independent evaluations.

2.7.91 It was disturbing to note that many decisions by the Board went against the recommendations of lending officers, and that the Board failed to justify its actions, often to the detriment of the VEDC. It can only be assumed that the Board either had available to it information which was not provided to audit, or that external forces had influenced the final decision.

2.7.92 Examples of the Board acting contrary to advice are detailed below:

J. & J.M. Musgrove Pty Ltd

Two instances were noted:

- In August/September 1987 the lending officer expressed grave concern to the Board regarding the VEDC's exposure and strongly recommended that no further funding be advanced to the company in view of its rapidly deteriorating financial position.

The lending officer stated in part:

> *"... the company continues to buy business without having any idea of their costs, their effects of discounting or the long-term ramifications...*
>
> *"... I do not feel it advisable to advance further monies or to offer concessions to a company that is basically trading blind, and for us to sit back and accept this situation is only fuelling an already rapidly deteriorating operation and being totally irresponsible towards ourselves and the investment we have made.*
>
> *"If we continue to pussy foot around with this company, then we can only look to our own inaction as the primary cause of a foreseeable multi-million dollar bad debt ... move to rectify the deteriorating situation that is now present, before it is too late".*

Despite the recommendation of the lending officer, the Board approved an increase in the guarantee facility of $1 million to $2.25 million (between September and November 1987) bringing the VEDC's total exposure to $12.1 million, a debt which according to the lending officer could not *"... possibly be serviced by the company given their present state of trading and mismanagement"*. The guarantee facility was subsequently extended to 30 April 1988. On 26 April 1988 the company was issued with a Notice of Demand and receivers/managers were appointed.

Had the recommendation been accepted a saving of $1.25 million would have been made by the VEDC.

- In May 1988, a report by the receivers/managers strongly recommended the immediate sale of the company as prolongation would result in market forces eroding the company's existing market presence. Subsequently, the company was advertised for sale and tenders were received on 4 July 1988, of which 2 were assessed as being acceptable. In the receivers'/managers' recommendation as to the most preferable tenderer it was stressed that delays by the VEDC in making a decision in selecting the successful tender were costing the VEDC $570 000 per month.

  Nevertheless the VEDC did not make a final decision until September 1988 with settlement not taking place until October 1988. The delay in finalising the sale cost the VEDC a further amount in excess of $1.5 million.

Islamic Abattoirs of Australia Pty Ltd

A firm of consultants engaged by the VEDC to evaluate the viability of Islamic Abattoirs of Australia Pty Ltd's feasibility provided a positive recommendation. Notwithstanding the consultants' report the lending officer expressed serious reservations about the viability of the company's proposal. The Board accepted the consultants' view and approved financial facilities to the company of $5.5 million during the period October to November 1987.

There was no evidence on file as to the reasons for the justification of providing financial assistance to the company in light of the reservations expressed by the lending officer.

Agents for the mortgagee in possession were appointed on 12 April 1988. At 30 November 1988 the company's debt to VEDC amounted to $7 million.

MONITORING OF LOANS

2.7.93 Effective monitoring of financial assistance provided should have been undertaken to minimise risk. The following points, while not exhaustive, should have been considered by management when monitoring loans:

- prescribed conditions surrounding the provision of finance have been adhered to;
- the value of securities of the borrower have not diminished thus jeopardising the recovery of finance;
- unprofitable trends have been detected so as to take corrective action in terms of protecting the VEDC's interests; and
- there has been continuing stability of management and expertise within the borrower's organisation.

2.7.94 The audit review disclosed that in many instances the VEDC failed to adequately monitor loans. In addition, in spite of the VEDC becoming aware of borrowers being unable to meet loan repayment commitments, further funds were provided. The provision of this additional finance increased risk and potential loss to the VEDC and diverted funds away from other secure ventures.

2.7.95 A review of loans disclosed the following deficiencies in the monitoring of loans and in the assessment and provision of further financial assistance.

Failure to follow-up loan conditions

2.7.96 The minimisation of risk should have been achieved by prescribing conditions on the provision of financial assistance. It was therefore necessary to ensure in the first instance that the applicant was, in fact, capable of complying with the conditions set. Having set conditions it was crucial that their enforcement was monitored.

2.7.97 The audit review found many instances where the conditions set by the Board had not been followed-up to ensure compliance. The failure to monitor such compliance resulted in the safeguards set by the Board becoming ineffective.

2.7.98 The following cases illustrate the consequences which resulted from a lack of such monitoring.

West Wimmera Grains Pty Ltd

In early 1987, a loan of $2 million was approved to enable the company to meet the total capital costs associated with the establishment of a bulk handling and baggage plant at Portland for the handling of peas and other crops for export. This project was to be completed by June 1987 at the latest.

Due to substantial cost overruns a further $1 million was provided to the company to complete the facilities.

A review of the loans provided revealed that the following conditions were not complied with:

- quotes for equipment/building works to be forwarded to the VEDC; and
- progress payments to be provided by the VEDC on receipt of supporting invoices and architect's certificates for building works.

Amounts of $345 000 and $272 000 were released without supporting documentation.

The facility cost approximately $4 million to build of which the VEDC financed $3 million but it remained incomplete in relation to the original plans. In September 1988, the company decided to cease operations at Portland as the turnover was insufficient to cover operating costs.

At 30 November 1988 the company's debt to the VEDC amounted to $3.3 million.

Baruda Properties Pty Ltd

In December 1986 the VEDC approved a loan of $2.4 million to finance the redevelopment of a motel/hotel at Trawool.

The following special conditions were included in the loan offer but were not satisfied, yet the VEDC allowed progressive drawdown of funds to continue:

- information required to satisfy the VEDC that work could be completed for the quoted price; and
- monthly progress reports to monitor works.

As stated earlier in this report, at 30 November 1988 the company's debt to the VEDC amounted to $4.3 million.

Waiving of special conditions

2.7.99 Most finance approvals by the VEDC contained special conditions aimed at safeguarding the funds advanced.

2.7.100 Audit noted that on a number of occasions special conditions had been waived without adequate authority or due consideration being given to the ability of the company to service the loan.

2.7.101 Examples were:

J. & J.M. Musgrove Pty Ltd

On 20 May 1987 the Board approved a loan facility of $10.8 million to effectively restructure the company's debt. This facility was subject to special conditions.

Subsequent to the advancement of funds the following special conditions were varied or waived through direct consultation between the General Manager and the company:

- requirement to have monthly performance reports within 14 days of each month end, relaxed to 21 days or thereabouts;
- requirement to provide monthly listing of creditors including ageing within 7 days of each month end, relaxed to 21 days; and
- requirement to have a working capital management program devised, implemented and monitored by a firm of chartered accountants not enforced.

In audit opinion the Board should have approved the variations made to the special conditions attached to a letter of offer, particularly as the Board was aware of the serious liquidity problems faced by this company.

Jacazlow Pty Ltd

This company, a manufacturer of automotive parts, was granted a series of loans from August 1986.

In June 1987 the Board approved a loan of $200 000, subject to the special condition that confirmed orders and deposits had to be lodged prior to the VEDC progressively advancing these funds.

Due to the company's cash flow problems this condition was later waived by the Board and the $200 000 was released on 25 August 1987 to pay unsecured creditors without a reassessment of the company's ability to repay the loan.

Within 2 months a receiver/manager was appointed by the VEDC and the business was subsequently sold in October 1988.

At 30 November 1988 the company's debt to the VEDC amounted to $1.9 million.

Diminution of security held

2.7.102 The assessment and acceptance of security offered at the time of initially making the loan is a basic requirement of loan management. Continuous monitoring to ensure the existence and value of those securities is a further process which cannot be ignored.

2.7.103 Audit found a number of instances where the value of security held over loan advances had been eroded. Where additional loans were provided the VEDC did not always prudently consider its increased exposure to risk.

2.7.104 Examples illustrating the diminution of value in security follow:

Australian Vintage Travel Pty Ltd

In October 1986 the VEDC approved a $6.5 million loan to the company to assist in financing the purchase of a tourist train (*Southern Cross Express*) and the refitting of a ferry (*South Steyne*).

Initially $4.7 million was offered (31 October 1986) to the company, together with an additional $1.8 million on the condition that an independent valuation commissioned by the VEDC would reveal the worth of the ferry upon completion to be a minimum of $8 million. The valuation report revealed the ferry's worth as a going concern of only $5 million. However, the additional $1.8 million was still provided to the company.

Additional loans of $7.4 million were later provided on the basis of valuations by the company of $12 million for the ferry and $3.6 million for the train. The VEDC accepted these valuations and the exposure and risk element with this project. However, later valuations obtained by the VEDC valued its security over the loan for the ferry at between $4 million and $6 million. A valuation for the tourist train was not obtained.

The VEDC provided additional financial assistance to the company to meet continual cost overruns.

At 30 November 1988, the company's debt to the VEDC amounted to $15.7 million. The VEDC's financial assistance to the company is significantly unsecured due to the substantial variation between the value of security and the company's debt to the VEDC.

Wind Technology Pty Ltd

The company obtained a fully-secured loan of $75 000 from the VEDC in September 1984.

At 30 November 1988 the company's debt to the VEDC was $847 500. In addition, the VEDC held equity in the company of $98 000. However, the level of security had remained unchanged at $75 000 resulting in the VEDC's financial assistance to the company being significantly unsecured.

Were funds used for the purposes intended?

2.7.105 Monitoring procedures should have been in place to ensure that loan funds were used for their intended purpose.

2.7.106 The following instances were noted where loan facilities provided by the VEDC were used for purposes other than those specified.

J. & J.M. Musgrove Pty Ltd

Subsequent to the initial loan funds of $1.5 million being approved and advanced to the company, it was brought to the Board's attention that **$250 000 was applied towards the construction of Musgrove's private residence on the South Warrandyte property. This was contrary to the purpose of the loan specified in the letter of offer** which was that the loan was to assist the company with the development of its farms.

Islamic Abattoirs of Australia Pty Ltd

Special conditions of the letter of offer dated 18 September 1987 specified: "... *the stamp duties and solicitors costs are to be directly disbursed by the Corporation to a limit of $500 000*". Actual costs amounted to approximately $435 000.

Audit noted that on 9 November 1987 the remaining advance of $65 000 was made by the Corporation to the company to cover the costs of maintenance, equipment and wages, etc. An officer from the VEDC commented that this was unacceptable as the $500 000 was specifically for solicitors costs and stamp duties.

Power International Pty Ltd

The VEDC invested $4.5 million in convertible notes with the company to enable the company to acquire a Victorian-based business. This acquisition did not eventuate and the VEDC presented the company with the following options:

- the funds be invested in another suitable Victorian-based company; or
- a full redemption of the convertible notes be made.

However, a dispute arose and the VEDC sought a legal opinion on its rights to seek a redemption of the abovementioned convertible notes. It was found that the agreement had been drafted in favour of the company and while the "spirit" of the intended use of the loan facility was not adhered to, the VEDC could not take any action to recover the funds until 1991, when the convertible notes are due to mature.

2.7.107 Although it was the VEDC's policy not to provide funding for research and development costs, an examination of loans revealed a number of instances where VEDC finance had been used primarily in this area. It is of concern that the VEDC continued to provide further funds to companies when they were aware that the moneys advanced were being spent on research and development.

2.7.108 Instances noted were:

Garwood Limited

The company was established to develop and produce specialised food packaging equipment.

Initial inquiries by the company for financial assistance in 1983 were rejected on the basis that finance was required for development purposes. Later a formal application was received from the company and the VEDC then assessed that the requirement for funds was for marketing purposes. An initial loan of $555 000 was approved in April 1985. To November 1988 the VEDC had provided financial assistance of approximately $20 million.

An internal VEDC analysis of the company dated November 1988 contained the following comments:

> "*It is perhaps too easy to argue that past mistakes should not be reinforced by subsequent errors of judgement, but, we are looking at the (rightly or wrongly) single largest VEDC exposure that has the potential to make many past errors pale into insignificance, in comparison.*
>
> "*Against stated policy, guidelines, etc., VEDC has funded the R&D cycle of Garwood...*"

At 30 November 1988 the company's debt to the VEDC amounted to $19.3 million. Receivers/managers were appointed by the VEDC in December 1988.

M.G.T.D. Australia Pty Ltd

The VEDC approved the funding to the company for the further development and the subsequent production of replica MG motor cars in November 1985.

At the time of the application for financial assistance, the VEDC was informed that much of the research and development of the motor car had been previously undertaken and that the company was in a position to commence production. Progressively, the VEDC advanced funds including loans of $2.8 million and equity of $250 000.

Subsequently the VEDC learned that the prototype was still in its infancy and that substantial inputs would be required to advance the prototype to the production phase.

The company was placed into receivership and sold in 1987. At 30 November 1988 the company's debt to the VEDC amounted to $1.9 million.

Provision of additional finance

2.7.109 The provision of additional financial assistance to companies was usually based upon the:

- perceived potential of the company, i.e. future projected sales;
- need for the company to be seen as a going concern; and
- need to attract investment in the company or potential buyers.

2.7.110 A review of loans demonstrated that the VEDC continued to provide additional funding to companies despite their deteriorating financial position.

2.7.111 The following examples illustrate this issue:

Tusko Nominees Pty Ltd

The VEDC provided substantial funding to the company based on its potential to generate large sales from its sand deposits. However, these sales did not eventuate. In June 1986 an attempt to sell the business failed. Subsequently the VEDC continued to fund the company on a 50/50 basis with a major bank. This involved an assignment of securities.

In a memorandum to the Board dated 20 May 1988 a lending officer stated that: *'Having gone this far, I believe we have little option other than to agree to provision of a further $100 000, close scrutiny to continue'.*

From March 1988 to November 1988 the VEDC provided additional funding of $475 000.

As indicated previously, at 30 November 1988 the company's debt to the VEDC amounted to $5 million. The VEDC's loans to this company have been classified as non-performing.

Dacos Pty Ltd

In June 1985, the company applied to the VEDC for additional funding of $1.7 million. In an internal memorandum to the Board from a lending officer dated 21 June 1985 the recommendation drew its attention to the following:

> *"... the company is currently at a critical point of insolvency and seeks further financial assistance from the VEDC.*
>
> *"... the company has overtraded from its highly geared structure to a point where delivery delays and resultant cash flow delays have seriously jeopardised the company's future.*
>
> *"Whilst the balance sheet confirms the company's insolvency, liquidity has been maintained through VEDC's existing long term loan facilities. Stocks and debtors are good and creditors remain confident in view of the companies prospects, client base and the presence of VEDC".*

Despite the poor financial position of the company, an additional loan of $1.7 million was provided in January 1986.

Due to financial difficulties, agents for the mortgagee in possession were appointed in July 1988. At 30 November 1988 the company's debt to the VEDC amounted to $6.1 million.

Datatran Systems Pty Ltd

Due to the financial difficulties encountered by the company the VEDC engaged a consultant to review its operations. The consultant reported that the company was insolvent at 31 May 1988.

The VEDC's General Manager, in June 1988, in a memorandum to the Board expressed the following concerns on the financial position of the company: *"... if one were to take a strictly commercial view, this insolvent company would have to be liquidated as soon as possible".*

However, the Board approved an additional loan of $600 000 to the company based on its future projected sales rather than liquidating the company.

As previously indicated, the company's debt to the VEDC at 30 November 1988 amounted to $3.3 million. The VEDC's loans to this company have been classified as non-performing.

Nicholas M. Laurence (Australia) Pty Ltd

From 1984 onwards the VEDC provided a series of loans totalling $3.4 million to the company. Due to the poor trading performance of the business, a receiver/manager was appointed in July 1987.

The VEDC agreed to fund the receiver/manager only to the extent that the value of the business as a going concern was greater than the likely recovery on winding up. Loans advanced during this period totalled $1.3 million.

The VEDC was advised by the receiver/manager in December 1987 that: *"... the assets that are to be applied against the debt owing to the VEDC will continue to be eroded at a rate of approximately $20 000 per week as discussed with you on many previous occasions".* **Regardless of this advice, the VEDC continued to advance funds to the company.**

Eventually the business was sold in March 1988. At 30 November 1988 the company's debt to the VEDC amounted to $3.9 million.

2.7.112 The audit review also identified a number of practices that the VEDC had used to assist companies that were unable to service their debts both in terms of repayment of principal and interest. These practices included:

- capitalisation of the interest payments;
- deferment of repayments of principal and/or interest payments;
- advancement of additional loans;
- conversion of loans to equity; and
- termination of the loan.

2.7.113 The adoption of a number of these practices resulted in a reduction of the cash inflow to the VEDC and increased exposure by continuing to fund companies which were obviously experiencing financial difficulties.

2.7.114 Where additional loans were provided to cover interest payments or repayments deferred, the loan continued to be regarded as a performing loan by the VEDC, whereas in fact this status was only being maintained by the use of VEDC funds. The inevitable result of this practice has now been highlighted in a substantial increase in the provision for doubtful debts.

2.7.115 Examples of the adoption of such practices are detailed below:

Wind Technology Pty Ltd

> From September 1984 the company has not been able to meet from its own resources any repayments to the VEDC of principal and interest owing on its loan facility. In fact, the VEDC had met these repayments by advancing new loans to the company.
>
> By 30 November 1988 the company's debt to the VEDC was $847 500. In addition, the VEDC held equity in the company of $98 000. The financial assistance provided to this company is now classified as non-performing.

Australian Vintage Travel Pty Ltd

> In December 1987 the VEDC provided loans to the company on the condition that $1 million of the amount provided was to be used to pay interest owed to the VEDC, thereby reducing by $1 million funds available for the working capital of the company.
>
> As mentioned previously, the company's debt to the VEDC at 30 November 1988 amounted to $15.7 million. The financial assistance provided to this company is now classified as non-performing.

Loan file documentation

2.7.116 In carrying out the review, audit experienced difficulties in examining the contents of loan files due to their poor structure. The files did not contain an index of their contents, often contained duplicated papers, copies of unsigned letters and papers filed out of sequence.

2.7.117 In addition to providing financial assistance by way of loans, the VEDC also assisted companies by:

- taking up equity;
- acting as guarantor;
- providing loans subject to the VEDC receiving a guarantee from the Treasurer; and
- in recent times, provision of ministerial letters of comfort.

EQUITY

2.7.118 The VEDC was empowered to provide financial assistance by way of the purchase of equity in companies. Guidelines developed by the VEDC provided that equity investments could be made:

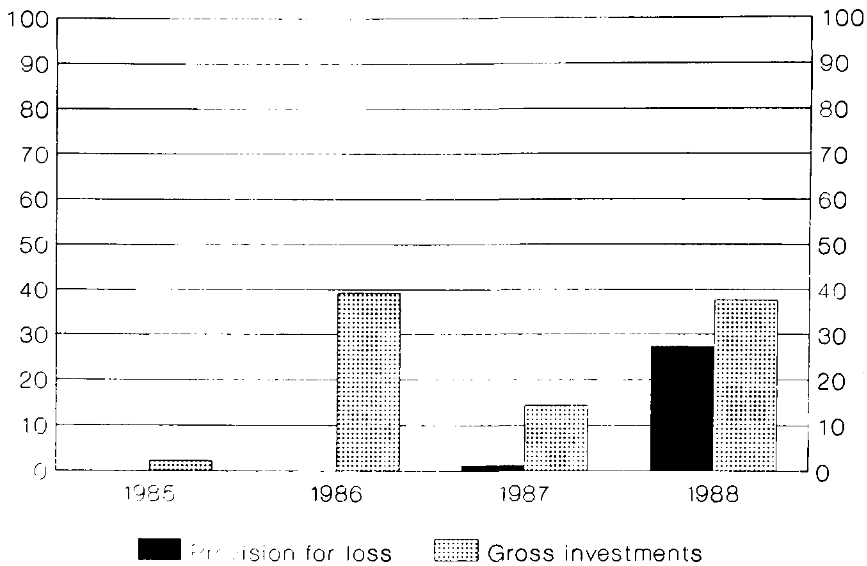
- when the Government or the Minister for Industry, Technology and Resources deemed it appropriate;
- in businesses which were in a start-up phase or expanding rapidly and which needed to conserve working capital, or where the cost of loan financing would inhibit growth;
- where it would assist the creditability of companies in negotiating for exports; and
- in *flagship* situations, provided they were consistent with the provision of the relevant legislation, where the entrepreneur perceived and the VEDC agreed that a VEDC minority equity investment may provide opportunities to the enterprise that might not otherwise present themselves and *government backing* can be used to advantage.

2.7.119 The evaluation of proposals to invest equity in companies required additional risk considerations because of the lower security ranking of equity when compared with loan finance.

2.7.120 To enable the VEDC to fund this type of investment, the Government increased the capital base of the VEDC from $2 million to $32.6 million.

2.7.121 Equity investments in companies by the VEDC at 30 June 1988 amounted to $37.7 million of which $27.4 million was considered unlikely to be recovered due to the poor performance of the companies involved. VEDC's return on its investments during 1987-88 was $16 000 (0.4 per cent). Chart 2.7I highlights the substantial increase in the provision for losses relating to equity investments.

CHART 2.7L
EQUITY INVESTMENTS, AT 30 JUNE
($ million)



2.7.122 The VEDC's financial position was, however, overextended as the ratio of its equity investment in other companies ($37.7 million) to its equity base ($32.6 million) was 115:100 at 30 June 1988. This meant that $5.1 million of the equity investments in companies had been funded by way of borrowings. The consequence of this action was that the VEDC had to pay interest on the borrowings during the period when there was little or no return on its equity investments. At the same time, the VEDC's overall financial position was deteriorating due to the large number of non-performing loans.

2.7.123 The VEDC had stated that it was one of its objectives to manage its financial resources so as to be able to return a dividend to the State. As $27.4 million or 72.7 per cent of equity investments are unlikely to be recovered from companies, this form of financial assistance would not appear to have been a sound financial strategy in pursuit of that objective.

2.7.124 A number of instances were noted where the VEDC converted existing loans to equity when companies were experiencing severe liquidity problems and were unable to service their debts. The VEDC's decision to convert loans to equity increased rather than minimised its risk because of the lower security ranking of equity when compared with loan finance.

2.7.125 Examples of equity investments in companies are:

Braemar Ltd

In December 1985, the VEDC approved a $2.5 million loan to Braemar Ltd (formerly Southern Braemar Ltd) to assist in the acquisition of a company in receivership, and to meet working capital requirements. At the time of advancing the finance, the VEDC's loan was fully secured.

Following poor trading performances the VEDC conducted a review of the company's financial position and concluded that "... *equity funds were required, or the alternative would be receivership*". Accordingly, in January 1988, the VEDC's Board approved the conversion of the loan to equity. At the time of conversion the VEDC's "security" position as an owner of the business had deteriorated as there was only 23c of assets for each $1.00 equity.

At November 1988, Braemar Ltd's 50c shares were trading at approximately 25c to 28c per share. VEDC holding was 5 million ordinary shares.

Wallace International Ltd

This company, which is involved in the development and marketing of pharmaceuticals and medical supplies, was advanced loans by the VEDC totalling $10.8 million from November 1986 to December 1988. These funds were advanced to assist in working capital needs and for research and development.

At September 1987 outstanding loans totalled $6.3 million. These loans had been provided upon the VEDC's expectation that a public share issue of $25 million in early 1987 would be successful and enable the repayment of VEDC loans. Due to delays encountered in the listing of the share issue it was rescheduled for October 1987. As a consequence of the share market crash in that month the underwriters of the share issue, Bain & Company Limited, were able to withdraw their support.

The VEDC continued to provide further loan assistance to the company of $4.5 million. The General Manager of the VEDC, without Board approval, and the Minister, agreed with Bain & Company Limited to sub-underwrite $12.5 million of the share issue.

The General Manager entered into the sub-underwriting agreement which is believed to have been executed on 6 November 1987. It was noted in the agreement signed by the General Manager that the wording "*by authority of the Board of Directors*" had been crossed out.

The ratification by the Board (VEDC) to this agreement did not take place until 19 February 1988. The Board minutes indicated some Board members were unaware of the agreement: "*Under no circumstances in the future will the VEDC tolerate another chain of events where they are presented with a fait accompli by management or any other factors associated therewith from outside sources and no decision will be given by the VEDC Board without the full facts being placed before them prior to any event taking place.*"

A VEDC Director, Mr Bradfield, requested that it be minuted that he and fellow Director, Mr J. Poulton were not aware of any of the circumstances surrounding Wallace International Ltd and Mr Poulton advised that he was abstaining from voting on any matters pertaining to Wallace International Ltd for the following reasons:

- lack of prior knowledge of events leading to sub-underwriting; and
- the need to sight all correspondence relevant to the matter and minutes of meetings with DITR, brokers and lawyers, underwriting and sub-underwriting agreements, and legal opinion covering the VEDC's liability and exposure.

A memorandum to the Board, also on this day, from the General Manager stated:

"I must point out here that whilst this matter was talked about informally with other Board Members there has never been a Minute put in the Board papers agreeing to or authorising the sub-underwriting agreement for which I take total responsibility and, to set the matter straight, I would ask that the Board confirm that authorisation now.

"To put it bluntly, the float has been a disaster with less than $2 million being taken up by the public, the rest being subscribed by Wallace himself, management of Wallace International Ltd, the Gas and Fuel Superannuation Fund and the VEDC".

As the share issue was not fully subscribed the VEDC was obliged to purchase $12.5 million of shares. From the proceeds of the share issue the VEDC was repaid all outstanding loans. In effect loans given by the VEDC were converted to equity and thus the risk of the investment increased.

In addition the VEDC also purchased another $2.75 million of shares from the share issue to honour a long outstanding commitment to the company.

At 30 November 1988 the VEDC had an equity investment in the company which cost $15.25 million. Audit understands that legal action is pending to recover some of the equity investment.

2.7.126 As mentioned in paragraph 2.7.118 of this report the VEDC was, under its guidelines, prepared to make equity investments in situations where government backing can be used to advantage. In audit opinion there is the danger that the term "government backed" can be translated into meaning "government guaranteed" with the consequence that some members of the community may be attracted to dealing with, or investing in, such companies in the belief that they would be unlikely to suffer any personal financial loss.

GUARANTEES

Provided by Treasurer

2.7.127 Instances were noted where the VEDC considered projects to be financially non-viable, however, because of government representation, they were prepared to provide financial assistance subject to the Treasurer issuing guarantees. If the companies failed to meet their obligations, then there would be a direct loss of taxpayers' funds when the VEDC called upon the Treasurer to meet the guarantees.

2.7.128 At 30 November 1988 loans provided to Wine Victoria Pty Ltd ($1 million) and N.A. Noulikas Constructions Pty Ltd ($3.6 million) were covered by a Treasurer's guarantee. Comments in relation to the guarantee provided by the Treasurer to N.A. Noulikas Constructions Pty Ltd are set out below:

N.A. Noulikas Constructions Pty Ltd (in liquidation)

The company was one of the first organisations to sign the State Government's Code of Conduct Agreement consenting not to pay members of the Builders Labourers Federation (BLF) a 3.8 per cent wage increase awarded in 1985. The outcome of the company signing the agreement was that the BLF ceased to provide the company with the labour necessary to carry out its contracts.

Due to the severe industrial disruption the company was unable to earn sufficient revenue to sustain its operations and was in urgent need of financial support. As a consequence the then Public Works Department (PWD) provided an advance of $1.5 million against future contract claims to enable the company to meet its financial commitments.

After the company expended the funds provided by PWD, the VEDC was requested in a letter dated 6 March 1986 from the then Minister for Employment and Industrial Affairs to *"... provide assistance to Noulikas by way of a loan or by guarantee or by whatever means you consider appropriate"*. The company applied for a $3.6 million loan to finance the working capital needs until the BLF dispute was resolved.

The VEDC assessed the proposal as most unattractive given the lack of security available and resolved that the facility would be provided only on condition that a guarantee for $3.6 million be given to the VEDC by the Treasurer of Victoria.

The guarantee was approved and the funds were advanced to the company between April and May 1986.

The company failed to meet any interest payments and by March 1988 the level of accrued interest exceeded $1.4 million. These arrears were causing liquidity constraints on the VEDC and in August 1988 the VEDC requested the Treasurer to make payment as a guarantor against the outstanding liability (security by his guarantee) to ease the liquidity situation and to eliminate the interest escalation.

On 19 August 1988 the Treasurer deposited the sum of $5.4 million with the VEDC on condition that the VEDC pursue recovery under the securities held against the loan, i.e. second and third mortgages. The conditions of the guarantee required the VEDC to take action to recover the debt from the sale of the securities before exercising its rights under the guarantee. This was a strange condition considering that it was the lack of security available in the first place that led the VEDC to conclude that it would only give a loan if the Treasurer guaranteed that loan.

It is doubtful whether the State will recover the $6.8 million (including interest owed by the company).

The Noulikas Group of companies have proved very expensive to the taxpayers of Victoria for in addition to the above the State Insurance Office instituted liquidation proceedings against a company within the Noulikas Group, N.A. Noulikas Holding Pty Ltd for non-payment of employer liability insurance premiums of $2.1 million. The State Insurance Office is unlikely to recover any of that debt.

Management response by DMB

As is acknowledged, the guarantee to Noulikas was provided as part of the Government's policy of assisting the BLF deregistration process undertaken by the construction industry. It is generally acknowledged that the high level of construction activity taking place in the Melbourne Central Business District is directly attributable to the success of that policy. The loss by the State of comparatively small sums of money as a result of calls on guarantees is vastly offset by increases in government revenue both directly and indirectly related to this renewal construction activity. It is therefore misleading to claim that the Noulikas Group of companies have proved expensive to the taxpayers of Victoria.

Acting as guarantor

2.7.129 In addition to direct financial assistance, the VEDC can act as a guarantor for assistance provided to industries by other financiers. At 30 June 1988 the VEDC had guaranteed the repayment of assistance amounting to $9.2 million. The provision of guarantees represents a high risk to the VEDC when a business is in financial difficulties, i.e. it cannot repay its financier, as it is then that the VEDC provides finance as a consequence of its guarantee.

2.7.130 An example of this form of finance is illustrated below:

Islamic Abattoirs of Australia Pty Ltd

> The company was offered assistance of up to $1 million by a trading bank to help meet its working capital needs. However, as the company could not meet the bank's security requirements, it requested the VEDC to guarantee the loan. Based on this guarantee the bank advanced the assistance requested. The company was unable to repay the loan and as guarantor the VEDC had to make the repayment. The amount of $987 700 paid was treated by the VEDC as an additional loan to the company.

Ministerial letters of comfort

2.7.131 In addition to approving loans where assistance exceeded $3 million to any one company, the Minister for Industry, Technology and Resources also issued a letter of comfort in relation to certain financial support provided by the VEDC.

2.7.132 In respect of the loan given by the VEDC to Kratner Limited, a loan which it was reluctant to make as it was to finance the purchase of a business which the VEDC had already placed in receivership, the Minister for Industry, Technology and Resources gave the VEDC a letter of comfort for financial support given up to a limit of $365 000.

2.7.133 On 31 August 1988 the VEDC had to call on the letter of comfort and DITR paid the VEDC the sum of $365 000. Audit is uncertain as to whether DITR was legally obligated by the letter of comfort to make the payment. However, irrespective of the legality of the letter of comfort, the taxpayers of Victoria have borne the loss.

2.7.134 The Treasurer had also issued a letter of comfort in relation to the VEDC's future obligations relating to the Victorian Equity Trust (VET), whereby the VEDC would, on the fourth anniversary of the allotment of units, purchase from unit holders whatever units they wished to sell. The Treasurer undertook to provide funding to the VEDC of the amount required to meet its obligations under the Deed. As the Treasurer had no legislative authority to issue a guarantee, the undertaking was given by way of a letter of comfort.

2.7.135 The VEDC's obligations under the Deed were assigned, by direction of the Treasurer, to the Rural Finance Corporation (RFC). It would appear that the government guarantee provisions contained in the *Rural Finance Act* 1988 will now apply to the RFC's obligations to unit holders of the VET.

2.7.136 The rights of Ministers to issue letters of comfort and how binding, if at all, are such letters on the government of the day, or subsequent governments, is not clear and audit is of the opinion that legal clarification should be sought.

RESPONSE TO ISSUES RAISED

From 1 December 1988 the Rural Finance Commission (RFC) took over the assets and liabilities of the VEDC with the exception of its shares in VIC Ltd and Wallace International Ltd.

On 17 March 1989, the RFC responded to the matters raised in this section of the report as follows:

> *In the short time available, it is not appropriate to respond in detail to all of the issues raised. However, we note that many of the matters which are the subject of criticism have already been addressed and corrective action instituted since the RFC took over responsibility for the operations of the VEDC on 1 December 1988. The additional matters raised in the report will be the subject of either detailed discussion with the Auditor-General or the implementation of policies and procedures to correct the identified shortcomings.*

2.8

APPENDIX

VEDC: CASE STUDIES

Many of the factors which contributed to the financial difficulties of the Victorian Economic Development Corporation (VEDC) are best illustrated by the inclusion of case studies of several of the major borrowers from the Corporation. These are:

- Australian Lucerne Co-operative Ltd;
- Australian Vintage Travel Pty Ltd;
- Dacos Pty Ltd;
- Garwood Limited;
- Islamic Abattoirs of Australia Pty Ltd;
- J. & J.M. Musgrove Pty Ltd; and
- Tusko Nominees Pty Ltd.

These case studies have been selected as they comprise a broad and varied sample of the major issues raised in this report. The presentation of the cases has been structured so as to provide the reader with an overall appreciation of the nature of the project, the amount of VEDC commitment, a logical sequence of the main events and a summary of the major areas of audit concern in relation to each case. It should be noted that audit had difficulty in gathering information on these cases due to poor file management procedures.

Throughout the review, audit noted the absence of qualitative targets of performance. Consequently, it was not possible to form an opinion as to the degree to which the financial assistance provided by the VEDC to industry in relation to certain of the cases examined did in fact achieve the desired results of increasing employment in Victoria, promoting tourism and creating additional export markets.

It must be appreciated that the persons involved in the decision making process relating to these cases did not have the benefit of hindsight at the time those decisions were made. Further, many of the decisions had to be made without the assistance of fully developed procedural and policy guidelines.

The Australian Lucerne Co-operative Ltd was established in 1985 to process and export lucerne stockfeed to overseas markets, particularly Japan.

The VEDC's association with the company began in November 1985 when a loan of $120 000 and a bill facility of $200 000 were approved to help with plant purchases and working capital requirements.

The VEDC did not undertake a detailed assessment of the business plan submitted by the company, the preparation of which was funded by the Department of Management and Budget (DMB). It relied on assertions of the company's Directors as to their ability to develop a successful export market as outlined in the plan.

The VEDC did, however, identify prior to advancing funds that:

- the company had a capital structure of only $15 000 and that this base was insufficient to support the funding requested;
- there needed to be close scrutiny of management control as this would be vital to the success of the proposal; and
- the identified export markets had distinct requirements for quality control and regularity of supply.

A special condition attached to the provision of assistance was that advances would only be made against confirmed export orders. There was no evidence that prior to advancing funds, the VEDC had ensured that orders existed. All that appears to have been presented by the company was estimated capital and working capital requirements.

To reduce the VEDC's risk, a guarantee for $440 800 was obtained from the Treasurer in January 1986, however, this has now expired. The guarantee was granted subject to, among other things, that there would be an initial limit of $216 500. The application of the guarantee to loan fund drawdowns in excess of the said amount would be subject to the Treasurer's specific approval and only upon certification from the VEDC that it had sighted further signed contracts. Audit could not find evidence that the approval of the Treasurer had been obtained to extend the guarantee when loan amounts exceeding $216 500 were advanced.

On 3 February 1986, a further $200 000 was advanced to the company. However, only 2 weeks later, following a meeting between the company and officers from the Department of Industry, Technology and Resources (DITR), DMB and the Department of Agriculture and Rural Affairs, the company was informed that: *"... the Government was no longer willing to assist financially due to the poor performance in delivering export orders. The government felt that irreparable damage was done to its future export marketing"*.

In a letter from DITR to the VEDC dated 26 February 1986 relating to the abovementioned meeting, it was stated: *"... in short, the organisation is operating at a loss, its management have no idea how to reverse this situation"*. The letter went on to say that further government assistance would be contingent upon a substantial increase in members' equity and whether the company was capable, if given further support, of trading into a profitable situation. In a report to its members on 9 April 1986 the manager of the company stated that for 1985-86 there would be an estimated trading loss of $90 000. However, on 24 April 1986, another $120 000 was advanced to the company.

The VEDC appointed a business consultant to examine the state of the affairs of the company, in particular, the likelihood of success in the 1987 season. The consultant concluded that a successful season was doubtful. The company Directors therefore recommended that the company be wound up and that the VEDC, being the sole creditor, be requested for instructions as to the winding up. Despite this recommendation the VEDC advanced another $185 000 on 8 December 1986. Further advances of $175 000 and $40 000 were also made on 17 February 1987 and 9 April 1987, respectively.

For the year ended 30 June 1987 the company made a net loss of $289 000. In an internal review document produced by the VEDC dated 16 October 1987 it was stated that: *"... the Co-operative is in a precarious financial state with net assets of negative $3 110 000 and technically insolvent. The VEDC is the only significant lender... and most at risk should circumstances deteriorate ... The Co-operative's debts servicing record... has been very poor with long delays experienced".* These comments were made after a further advance of $60 000 had been made.

The company had difficulties in repaying its debts which was attributed to a shortage of supply during the 1986 season and a disastrous season in 1987 due to a glut on the international market.

In a letter from the VEDC to DITR dated 29 November 1988, DITR was asked to consider a further funding request of $330 000 received from the company. Despite the unlikely recovery of the advances already made to the company, the VEDC was still willing for either itself or another government agency to provide additional funding.

At 30 November 1988 the company's debt to the VEDC amounted to $945 000.

In December 1988 the VEDC held a registered first mortgage debenture over the assets and undertakings of the company, which had been assessed at $100 000.

Audit concerns with regard to the provision of financial assistance to the company included:

- **failure to undertake a detailed assessment of the business plan submitted by the company;**
- **the company was informed that the Government was no longer willing to provide assistance only 2 weeks after it was advanced funds;**
- **despite a condition that funding would be made only against confirmed orders, there was no evidence that the VEDC ensured that orders existed;**
- **despite the special conditions attached to the guarantee, the approval of the Treasurer was not sought as required; and**
- **despite the company incurring trading losses, the VEDC continued to provide funding, even to the extent that when it was unable to provide funds itself it tried to obtain funding through another government agency.**

In October 1986, the VEDC approved a $6.5 million loan to Australian Vintage Travel Pty Ltd (AVT) to assist in financing the purchase of the former *Melbourne Limited*, a tourist and convention train, and to assist the refitting of the ferry *South Steyne* .

The tourist train was previously owned by Melbourne Limited Partnership (in liquidation) which encountered financial difficulties and was unable to repay debts amounting to more than $3 million, including a $950 000 VEDC loan. The main factors contributing to the existing financial difficulties were cost overruns, union problems, insufficient client support and poor financial control.

The initial application by AVT for assistance from the VEDC was made in June 1986 for a $4.7 million guarantee facility which in July 1986 was increased to $6.5 million. Discussions held by the VEDC and AVT management concluded that a loan facility of $6.5 million, rather than a guarantee facility, would make the project far more viable. AVT's capital contribution at the initial loan application stage consisted of only $100.

On 18 July 1986 the Board of the VEDC approved the loan application, in principle, on the following conditions:

- ministerial approval would be obtained; and
- a valuation for the ferry would be obtained and that the valuation be for a minimum of $8 million.

A valuation was obtained by the company that estimated the value of the ferry, on completion, at between $7.5 million and $8.5 million. However, a second (undated) valuation estimated the value of the ferry, on completion, to be only $5 million. Irrespective of this subsequent valuation, the loan for $6.5 million was provided by the VEDC.

The decision to fund the project was based upon information contained in the business plan which generally lacked detail. In particular:

- market surveys were not attached;
- estimated costs and completion dates for the capital program were not stated; and
- fare structures for the ferry and the train were not indicated.

In addition there was no indication that future cash flow projections for the company were critically assessed by the VEDC. The lending officer expressed the following concerns: *"... the projections ... are certainly very, very, optimistic. To increase from $3.085 million turnover to $18.2 million in 3 years would be a remarkable achievement".* Despite this warning the officer stated that while no independent assessment was undertaken they were satisfied with the budget for one year and recommended Board approval.

In August 1987 the Chairman and General Manager of the VEDC were appointed nominee directors of AVT and in November 1987, due to substantial cost overruns in the refurbishment of the ferry, additional financial assistance of $7.5 million was requested by AVT. These funds were provided on the basis of valuations provided by the company of $12 million for the ferry and $3.6 million for the train. These valuations, although substantially greater than the previous valuations, were not queried by the VEDC.

The report by the lending officer recommended that the loan application be declined, however, the lending officer was subsequently requested by the General Manager to amend the report so as to summarise the positive aspects of the proposal. The revised report included the following comment: "*...only success of the venture could be acceptable to the future of the Corporation. Absence of success would be potentially fatal for all*". However, the report did not include a recommendation to the Board.

The Minister gave his approval for the additional financial assistance of $7.5 million on 24 December 1987 on the condition that every endeavour would be made to attract equity investments to the company. Although no minutes of a special Board meeting of 24 December 1987 can be located, it is understood that on this date the Board approved the additional $7.5 million loan and that advances were made that same day.

A condition of the loans was that $1 million of the amount advanced was to be used to pay interest owed to the VEDC, thereby reducing by $1 million funds available to the company for working capital purposes.

In May 1988 an additional advance of $500 000 was made in order to provide continued support for trading by AVT. However, in July 1988 the VEDC appointed a receiver/manager to the company.

Due to significant trading losses, the train ceased operations in September 1988 and ferry cruises ceased on 31 December 1988. Negotiations for their sale are continuing with interested parties.

The funds to be recovered by the VEDC are dependent upon the proceeds received from their sale. The VEDC valued the ferry in September 1988 at between $4 million and $6 million and the train in October 1986 at $1.3 million.

At November 1988 the VEDC's involvement with AVT stood as follows:

TABLE 2.8A. INVOLVEMENT BY VEDC

Item	*$*
Principal outstanding	13 685 615
Interest accrued	1 526 454
Equity taken by VEDC	100 000
Funding provided to receivers/managers	400 000
Total VEDC financial involvement	**15 712 069**

Specific audit concerns relating to the VEDC's involvement in AVT included:

- The VEDC commitment to the company appeared open-ended;
- Business plans and future cash flow projections were poorly prepared and grossly inaccurate. In addition, the VEDC failed to critically assess these prior to advancing funds;
- The appointment of the VEDC's Chairman and General Manager to the AVT Board resulted in a conflict of interest;
- Failure to obtain adequate or independent valuations of their security prior to increasing the VEDC's exposure;
- Supporting a company where there was minimal financial commitment to the project by the owners; and
- The direction by the General Manager to the lending officer to amend his recommendation.

Data Cable Pty Ltd was established in 1980 to produce computer connector cables as a product which could be competitively manufactured in Australia to meet specific needs for which there would be a continuing demand.

Loan advances of $100 000 and $600 000 were approved by the VEDC to the company on 27 February 1984 and 21 December 1984, respectively. However, actual funds taken up amounted to $550 000 and a guarantee facility of $100 000 was also provided. The purpose of the funds was to assist the company with working capital requirements and to finance the purchase of plant and equipment. However, a substantial proportion of the funds were used by the company to meet operating costs including research and development activities.

Early in 1985, the company experienced cash flow problems. Consequently, it sought an additional $1.7 million loan in June 1985 at a time when the VEDC assessed the company as insolvent. An internal memorandum to the Board from a lending officer dated 21 June 1985, concerning the application, stated:

> *"... the company is currently at a critical point of insolvency and seeks further financial assistance from the VEDC.*
>
> *"... the company has overtraded from its highly geared structure to a point where delivery delays and resultant cash flow delays have seriously jeopardised the company's future.*
>
> *"Whilst the balance sheet confirms the company's insolvency, liquidity has been maintained through VEDC's existing long term loan facilities. Stocks and debtors are good and creditors remain confident in view of the company's prospects, client base and the presence of VEDC".*

Nevertheless, the $1.7 million loan was approved on the basis of the growth and profit prospects of the company given an agreement to manufacture certain products for a company in America.

However, consideration was not given to:

- the significant risks attached to high technology product development;
- the difficulties in establishing a successful distribution network overseas;
- the difficulty in attaining market acceptance for a new product;
- the danger of delays in product completion; and
- the need for quality control.

The guarantee facility was increased to $300 000 and the $1.7 million loan was advanced on 10 January 1986.

Security over funds advanced was assessed by the VEDC to amount to $1.4 million, however, this figure was overstated as it included $850 000 of the $1.7 million loan. The security consisted mainly of a second debenture charge over all the assets of the business. The nature of this security was such that it could easily be eroded in the normal process of operating the business.

During the period of the loan, the VEDC had also provided substantial guarantees to a major trading bank to ensure lines of credit for the company. In addition, a further loan for $500 000 was approved, in principle, by the Board in February 1987. However, the loan was never provided.

The company continued to experience cash flow difficulties as projected sales of its products did not eventuate. In July 1988 agents for the mortgagee in possession were appointed by the VEDC to administer the company's affairs.

At November 1988 the VEDC's commitment to the company stood as follows:

TABLE 2.8B. VEDC INVOLVEMENT

Item	*$*
Loans outstanding	2 150 000
Guarantee payout to bank	2 980 796
Interest arrears (approximately)	995 000
Total VEDC involvement	**6 125 796**

Specific audit concerns relating to the VEDC's involvement in the company included:

- **additional funding provided to the company irrespective of the VEDC having assessed the company as insolvent;**
- **the VEDC's failure to critically assess the difficulties and issues involved in establishing an overseas marketing operation prior to advancing funds;**
- **substantial funds used by the company for working capital purposes including research and development activities which did not add to the company's fixed asset base nor contribute to the ability of the company to eventually repay loans; and**
- **security held by VEDC was minimal when compared with the level of finance provided.**

Since 1985, the VEDC has provided a range of financial facilities to Garwood Limited (Garwood) to assist with the growth and development of a controlled atmosphere packaging (CAP) system that prolongs the packaged shelf life of food products.

Funding of $555 000 commenced in April 1985 when a business plan was submitted. Despite the plan's general nature and an absence of market surveys, the VEDC believed the company was worthy of support.

In May 1985 the VEDC had knowledge that Garwood was starting a new development when undercapitalised, existing premises were restrictive, expected sales had not occurred and ability to export competitively had not been analysed. Despite these concerns the VEDC provided financial assistance in 1985 of $1.4 million.

The VEDC continued to fund Garwood in 1986 in anticipation that a public share float would eventuate. Funding of $4.5 million was provided which included loans for the purchase of new factory premises. This was given even though the VEDC knew the company was experiencing liquidity problems, development of the CAP system was still ongoing and there had been a reduction in borrowing facilities from a bank.

In a memorandum to the VEDC's Board from the lending officer in December 1986, the following comment was made upon an application from Garwood for a $750 000 loan: *"We understand that losses, which have averaged $200 000 per month, are being contained but continued expansionary developments and lack of an adequate capital base is hindering the Company's trading performance"*.

Approval was given largely as a result of the VEDC's commitment to support the company through to listing on the stock exchange.

In February 1987 a public share issue raised $6 million providing much needed capital for the company, however, insufficient funds for working capital needs. Audit noted that these funds in part were utilised to:

- purchase Atmosphere Packaging Pty Ltd for $861 789, the major shareholders of Atmosphere Packaging Pty Ltd being 2 directors of Garwood (a loan given by the VEDC to Atmosphere Packaging Pty Ltd in 1985 of $92 000 remained outstanding);
- repay a $300 000 loan to Planet Resources, a company owned by another Garwood director;
- repay $2 million to the VEDC; and
- pay other creditors.

The VEDC continued to provide funding in 1987 to assist working capital needs, cover losses, reduce creditors and purchase additional machinery.

The VEDC agreed in September 1987 to the sale of one of Garwood's properties over which the VEDC had a registered mortgage. The VEDC had assessed this security at $203 000.

Mr A. Garwood, a director of Garwood, requested with his Board's approval that the anticipated proceeds of the sale (later sold for $260 000) be paid to him to reduce 3 overdrafts he had incurred in operating Garwood Packaging Pty Ltd (now Garwood) and to pay outstanding holiday pay accrued over 15 years. The VEDC agreed to this request subject to $100 000 being paid to the VEDC to help offset arrears. The sale of the premises, however, resulted in a worsening of the VEDC's security position.

In November 1987 the VEDC was conscious that the company was in a precarious financial position incurring operating losses of $300 000 per month, and that the company's bankers had withdrawn an offer of bridging support due to inadequate security. In addition, the company had deferred a planned convertible share note issue of $12 million following the share market crash.

The Board subsequently approved, in November 1987, finance of $1.4 million which had been advanced prior to Board approval. The VEDC also informed the company that no more funding would be considered.

However, a meeting in December 1987 between the company and Messrs Currie, Walker and Beattie (VEDC), held to discuss problems with the company's management and lack of direction, resolved that the VEDC would acquire 8 million shares in Garwood at 40 cents per share; a further commitment of $3.2 million. This involved the acquisition of 8 million shares in the capital of Garwood from Trenthor Investments Pty Ltd and Macgar Holdings Pty Ltd.

As these shares were held in "escrow", the purchase of these shares was not to be formalised until 20 March 1989, but funds were to be advanced against an assignment over share transfers and share certificates. Conditional upon this was Trenthor Investments Pty Ltd and Macgar Holdings Pty Ltd lending $3 million interest-free to Garwood and retaining $200 000 for their own purposes.

In June 1988 a further agreement was reached where the VEDC agreed to convert their equity to a loan with Garwood with the shares forming security.

In 1987 the VEDC provided financial assistance of $9.4 million. The Minister's approval was required for advances made in excess of $3.2 million, but was not sought until June 1988. At that time approval was also sought for advances already made in 1988 of $3 million and for future advances of $1 million.

The $4 million advanced in 1988 was as a result of orders placed for 3 CAP machines. In November 1988 the VEDC was informed by Garwood that an additional $2.8 million was required to trade on to March 1989. The VEDC advised the company that no more funding was to be provided.

Financial assistance provided at November 1988 totalled $19.34 million and comprised loans ($16.29 million), equity ($500 000) and leasing finance ($2.55 million). In addition, in June 1986 the Department of Industry, Technology and Resources approved loan assistance of $700 000, of which $600 000 had been advanced.

Receivers/managers were appointed by the VEDC in December 1988.

From a review of loan documentation, audit ascertained that the VEDC had primarily funded the research and development of the CAP system. An internal VEDC analysis of the company dated November 1988 contained the following comment:

> *"It is perhaps too easy to argue that past mistakes should not be reinforced by subsequent errors of judgement, but, we are looking at the (rightly or wrongly) single largest VEDC exposure that has the potential to make many past errors pale into insignificance, in comparison.*
>
> *"Against stated policy, guidelines etc. etc. VEDC has funded the R&D cycle of Garwood..."*

Audit concerns with regard to the provision of financial assistance to the company included:

- **the commitment by the VEDC to the company appeared open-ended;**
- **the VEDC believed the company was worthy of support although the company's business plans were poorly prepared and did not include a market survey;**
- **funds advanced were expended on research and development which was against VEDC policy;**
- **the company started the development of its products undercapitalised;**
- **the VEDC security position with the company deteriorated over the period finance was provided;**
- **funds were advanced prior to Board approval; and**
- **the VEDC did not seek ministerial approval prior to the issue of $6.2 million of financial assistance.**

Islamic Abattoirs of Australia Pty Ltd (Islamic) was established to operate an abattoir on stringent "Islamic principles" as to the method of killing animals. Adherence to these principles was expected to instil confidence in meat products for export to Muslim countries such as the Middle East and South-East Asia.

The company's original finance proposal in March 1987 was for the VEDC to issue a guarantee to a Middle East bank for a loan of $10.5 million to be provided for the purchase and upgrading of an existing, but non-operational, abattoir at Brooklyn including recommissioning the plant to US Export Licence Standard.

In evaluating the proposal the lending officer included the following comment: *"As has been outlined the directors together with their consultant have been less than forthright in their discussions with us".* The VEDC formally declined the proposal in July 1987, however, the file refers to a meeting to be held between DITR and the VEDC to discuss development of a second proposal.

The second proposal was for the VEDC to fund Islamic in the purchase of the abovementioned abattoir for $6.3 million. A consultant was engaged by the VEDC to evaluate the proposal and his report stated that the operation of the abattoir was viable but expressed the view that Islamic would have to increase the amount of equity funding to between $4.5 million and $5 million. The company's equity base at that time was $500 000 and it indicated that it could provide the necessary equity funding.

The lending officer in assessing the second proposal expressed concerns that:

- the source of the equity injection was unknown and there was doubt, based on an earlier proposal, that it existed;
- the management skills of certain Directors of the company were in doubt; and
- a consultant to the company had, in a telephone conversation with a lending officer, expressed doubt that any funds provided by the VEDC would be fully applied to the purchase of the Brooklyn abattoir.

The lending officer's recommendation supported by the Manager Lending was that the proposal be declined. The Manager Lending, in addition to reservations as to the lack of management skills, also believed the price being paid for the abattoir was excessive. He concluded by stating: *"There are too many negative aspects of the proposal and despite the revised funding proposal, the application is recommended for decline".*

The lending officer, however, added a proviso to his recommendation that should the Board approve of a loan it should be conditional; one condition being that Islamic provide evidence of the injection of an additional $4 million in equity.

On 18 September 1987 the Board approved a loan of $4.5 million and a guarantee facility of $1 million over funding to be provided to Islamic by a trading bank. The Board minutes did not indicate that the loan was to be made without the conditions included in the lending officer's recommendation.

Subsequently the lending officer prepared a letter of offer on the understanding that the condition relating to the $4 million equity injection was to be included. The lending officer was then informed by the General Manager that there was no cash equity available. The Chairman confirmed that the offer was to be made without the equity condition.

Of the loan facility originally approved of $4.5 million, an amount of $500 000 was to be applied directly by the VEDC in the payment of Islamic's legal expenses and stamp duty. Actual expenditure for these purposes amounted to $435 000, however, the VEDC, contrary to the loan conditions, paid the balance of $65 000 to Islamic to meet the cost of maintenance, equipment and wages.

The abattoir commenced operations soon after and although some specific export contracts were fulfilled, to gain market acceptance, it was necessary to accept a number of contracts on which a relatively low margin was achieved. In December 1987 the VEDC expressed concern at the unprofitable number of animals being killed. It was at this time that the VEDC first became aware that the company had invested moneys in Malaysia. It would appear that not all members of Islamic's Board were aware of this transaction, for in February 1988 Islamic's Board directed 2 of the Directors to return the funds invested in Malaysia. On 11 March 1988 the VEDC, by letter to the Chairman of Islamic, demanded that the 2 Directors, who were overseas, immediately make available the $615 000 they had guaranteed would be back in Australia by the end of February 1988. The money had not been returned at the time of the audit review.

A significant attempt was then made by Islamic to attract equity investment and restructure its finances, all of which failed, and combined with escalating stock prices the company ran into considerable liquidity difficulties. A report to the VEDC in April 1988 indicated that Islamic was insolvent. To protect its interests the VEDC appointed "Agents for the Mortgagee in Possession". The Minister, in June 1988, approved of funding the Agent up to $420 000. The approval was subsequently raised to $840 000.

In August 1988 the trading bank called upon the guarantee facility for an amount of $987 000.

At 30 November 1988 the company's debt to the VEDC was $7 million.

Specific audit concerns relating to the VEDC's involvement in the company included:

- that having declined the company's original proposal and expressing reservations as to the information supplied by Islamic's directors, the VEDC encouraged the company to put forward a further proposal;
- funds provided even though the management skills of certain Directors of the company were in doubt;
- while recognising that the VEDC's Board had ultimate responsibility for approving loans, there was no documentation of the reasons why the lending officer's recommendations were not accepted by the Board;
- VEDC management advanced funds to Islamic outside the conditions set by the Board; and
- financial assistance provided was not fully applied for the intended purpose.

J. & J.M. MUSGROVE PTY LTD

The Musgrove family had controlled a company trading under the name of Fantasy Egg Farm (Vic) Pty Ltd since its incorporation in November 1973 until July 1986 when the name was changed to J. & J.M. Musgrove Pty Ltd.

The company in recent years has concentrated its efforts in setting up a fully integrated operation for the breeding of laying and broiling poultry. This development was scaled up after the acquisition by Inghams of the remaining poultry breeders in NSW and Victoria in 1985. These acquisitions had left the company, as well as all independent egg and poultry producers, vulnerable as to their source of supply with Inghams now controlling approximately 70 per cent of the marketplace.

The company received loans totalling $2 million and a bill facility of $1 million in the first half of 1986 without providing the VEDC with any audited financial statements. Of these advances, $250 000 was applied towards the construction of the Musgrove's private residence on the South Warrandyte property contrary to the purpose for which the advances were made.

By February 1987 it was evident that the company was facing severe cash flow problems and a major bank which had lent the company $6.5 million moved to increase its priority claim over the assets of the company. Following a further loan application, the VEDC commissioned a major firm of chartered accountants to report on the financial position of the company and its future trading prospects. The firm recommended that the company be advanced a further $5.6 million and that the total advances be consolidated into an interest-free facility of $8.6 million. It also recommended that the company be subjected to effective controls on expenditure and regular external monitoring.

The Board approved a loan facility of $9.8 million (including the original $3 million) and a guarantee facility of $1 million to restructure company debts. The Board attached a number of special conditions to the loan facility of $10.8 million which represented the VEDC's total exposure to the company. The Minister gave his approval to the $10.8 million loan facility and the moneys were advanced in July 1987. Subsequent to the Board approval, several of the special conditions were either varied or waived by the General Manager with the agreement of one Board member without reference to the Board, thereby weakening the VEDC's position.

Within approximately one month of the Board approving the new loan facility, the responsible loans officer expressed grave concerns regarding the VEDC's exposure and strongly recommended no further funding be provided to the company due to its rapidly deteriorating financial position and that a receiver/manager be immediately appointed. No action was taken until the Board meeting on 12 November 1987, following a further memorandum from the loans officer whose recommendation was now supported by 2 senior managers.

The Board decided to appoint an unofficial manager/advisor to prepare an investigative report to determine the best alternatives for debt recovery or minimising potential losses. The Board considered it most undesirable to appoint an official receiver at that time as it was still hopeful of gaining significant private equity participation. Prior to receiving the investigative report, the General Manager increased the guarantee facility to $2.2 million, thereby increasing the VEDC's overall exposure to $12.1 million. The report identified major security problems and concluded that unless significant equity participation could be found in a very limited period, the VEDC should take appropriate action under its security.

Notwithstanding the exposure of the VEDC, the Chairman, General Manager and one Board member agreed to release a Mercedes Benz car and egg packing machine (with a total value of $170 000) from securities held by the VEDC.

Eventually, official receivers/managers were appointed in April 1988, some 8 months after the loans officer recommended such action. The company was sold for $14 million. The VEDC entered into an arrangement with the purchaser whereby the purchaser would pay $4 million cash to the VEDC to offset amounts owed by the company. The VEDC would then provide to the purchaser a loan of $10 million which was to be conditionally interest-free for a period of 2 years and used to pay loans outstanding by the company. This transaction was effected in the VEDC's records by extinguishing the $10 million owed by the company and the creation of a loan for that amount to the purchaser.

Although the VEDC's exposure had been reduced by $4 million it was at a cost of approximately $3.4 million, being the interest foregone during the interest-free period (at an assumed rate of 17 per cent). This factor cannot be overlooked in any assessment of the financial implications to the VEDC of the sale of the company.

Specific audit concerns relating to the VEDC's involvement in the company included:

- **severe cash flow problems existed prior to granting additional loans beyond the initial $3 million;**
- **loans were applied for purposes other than those specified;**
- **VEDC exposure was increased without Board approval;**
- **security was released thereby increasing VEDC risk;**
- **several of the special conditions to the loan facility were either varied or waived without reference to the VEDC's Board;**
- **delays in decision making by the VEDC; and**
- **VEDC reduced the loss/exposure of 2 major banks, by providing government guarantees.**

The company first received financial assistance in February 1984 when an initial loan of $988 000 was approved to establish a sand processing operation.

The lending officer in his report to the Board stated that the request for assistance could not be supported based on the company's financial position and lack of management ability. However, the report went on to state that: *"... there is some justification for endeavouring to assist in some way with the development of what could be the most valuable sand deposit in Victoria if not Australia with large potential overseas markets. In addition it is considered that the venture could be run extremely profitably under proper management".*

Reservations as to the commercial viability of the project had also been expressed by the then Department of Minerals and Energy due to the unsuitability of the sand and the amount of overburden to be removed prior to obtaining access to the sand. The VEDC's response to the Department stated that it was satisfied the project was viable.

A business plan to support the project had not been submitted by the company to the VEDC and in assessing the project no consideration had been given to the cost of removing the overburden.

The VEDC based its decision to provide finance upon information provided to the company by a consultant, and an expectation that the company's scoria operations would generate any additional funding required.

On 17 August 1984 the VEDC approved a further loan of $698 000 as a result of the company experiencing liquidity problems and the need to upgrade plant and equipment for its scoria operations. This loan was conditional upon the company providing an equity contribution of $500 000, the provision of monthly financial statements and approval from the Minister for Industry, Technology and Resources.

However, the company was unable to attract the required equity contribution and it failed to provide monthly financial information to the VEDC.

In an internal memorandum from the loans officer to the General Manager dated 1 November 1984, the officer stated that: *"Without the additional capital there is no way that the project can be completed and all creditors paid. If this situation continues we have no alternative but to issue a demand".* Reference was then made that, to demand repayment would effectively mean putting the company into receivership. The officer then concluded with the following statement: *"The alternative is to continue paying part of the expenses and wages necessary to keep the sand-project going to avoid a reflection on the Corporation for being instrumental in the downfall of the company".*

The Board, with the Minister's approval, amended the loan condition relating to equity contribution so that the VEDC could convert $500 000 of the company's loan to equity.

By March 1985 the sand plant had not been completed and the lending officer in a memorandum to the General Manager dated 15 March 1985 stated: *"The writer is of the opinion that it would be advantageous if we could cease funding now as it is apparent that the remainder of the funds will not enable production to commence".*

In May 1985, at the VEDC's request, the Minister approved the appointment of a receiver/manager (the receiver) whose preliminary report indicated that the company's records and project control were totally inadequate. In addition, the report indicated that there was no distinction in the records between the company's operations and those of the family trust for which the company acted as trustee.

The VEDC instructed the receiver in October 1985 to sell the company. Action on the decision was deferred to allow the company to seek equity partners, however, negotiations were unsuccessful. In June 1986 the business was advertised for sale but no offers were received. During this time the VEDC continued to fund the receiver.

In late 1986 a bank agreed to provide funding to the company subject to being given first priority over the assets to a value of $1.8 million. The VEDC agreed to the bank's proposal as to the security position and to share further funding with the bank on a 50-50 basis. The VEDC felt that if it did not do so it would lose the funding provided to date of $3.8 million.

In a memorandum to the Board dated 20 May 1988 a lending officer stated that: *"Having gone this far, I believe we have little option other than to agree to provision of a further $100 000, close scrutiny to continue".*

From March 1988 to November 1988 the VEDC provided additional funding of $475 000.

During 1988 the company continued to operate on a loss. A consultant's report in October 1988 commented that there was no immediate future for the sandpit and the high cost of running the operation was attributed to a lack of planning, managerial supervision and direction.

At 30 November 1988 debt to the VEDC was $5 million.

A valuation of the land, plant and equipment in October 1988 disclosed that the value of realisable assets only covered the security held by the Bank.

Specific audit concerns relating to the VEDC's involvement in the company included:

- **even though the VEDC was aware of the company's poor financial position and lack of management ability, finance assistance was provided;**
- **funds were advanced even though reservations were expressed by another agency as to the economic viability of the project;**
- **a business plan to support the project was never submitted;**
- **the failure of the VEDC to take steps to ensure that the company provided regular financial reports meant that effectively the VEDC was unaware of whether the financial assistance it had provided had been used for the intended purpose;**
- **the VEDC's commitment to the company appeared open-ended even though the company continued to experience liquidity problems; and**
- **the VEDC's security position with the company deteriorated over the period financial assistance was provided.**