



Victorian Auditor-General's Office

REPORT ON

MINISTERIAL PORTFOLIOS

MAY 1994

Auditing in the Public Interest

VICTORIA

Auditor-General
of Victoria

**REPORT ON
MINISTERIAL PORTFOLIOS
MAY 1994**

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May 1994


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

Sir

Under the authority of section 48 of the *Audit Act* 1958, I transmit my *Report on Ministerial Portfolios*. The Report also contains a section on the Parliament of Victoria and a review on financial reporting in the Victorian Public Sector.

This Report completes the cycle of my auditing activities in relation to the 1992-93 financial year, and reflects ministerial portfolios and responsibilities operative at the end of March 1994.

Yours faithfully


C.A. BARAGWANATH
Auditor-General

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Foreword

Over the last decade, successive Auditors-General have been calling for reform of legislation governing resource management in the Victorian public sector. In his *Report on the Treasurer's Statement for the year ended 30 June 1987*, my predecessor, R. G. Humphry, concluded at that time that a major assessment should be undertaken of the adequacy of the State's resource management systems and processes, and that a higher priority needed to be given to the upgrading of the State's audit and financial administration legislation.

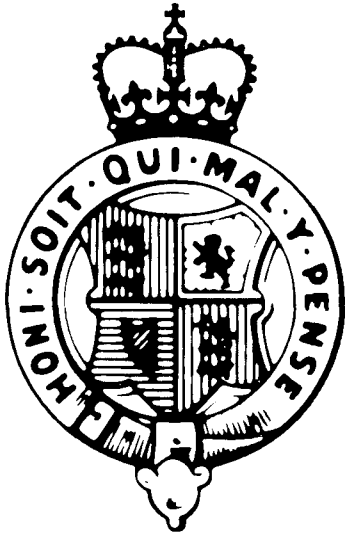
Since that time, numerous commentators have also called for reforms of the audit and financial management legislation which I have variously described as outmoded and Dickensian. In its report on the condition of the Victorian State public finances, the Victorian Commission of Audit stated that there were significant deficiencies in the State's financial management system, that the current financial reporting and internal control processes did not provide adequate accountability for the use of government resources, and expressed the view that Victoria should fundamentally redesign its public sector management processes.

In addition, the Victorian Commission of Audit concluded that while the current external auditing arrangements were working effectively, the role of the Auditor-General could be enhanced by strengthening the relationship with the Parliament and that the current system whereby the Auditor-General relies on the Executive Government for funding should be replaced by a system under which the Victorian Auditor-General's Office would be funded by a Special Appropriation under the control of a Parliamentary Committee. Similar views were expressed by the Public Accounts and Estimates Committee in a report tabled in Parliament in November last year.

As part of its financial reform process, the Government has acted promptly to resolve the above concerns through new audit and financial management legislation which has recently been passed by the Parliament. These reforms should maintain the improvement in accountability and resource management within the Victorian public sector, although the question of improving the Auditor-General's nexus with the Parliament still remains to be addressed.



C.A. BARAGWANATH
Auditor-General



Part 1

Executive Summary

Part 1.1

Major findings

1.1.1 **Key findings** arising from the audit reviews of ministerial portfolios are highlighted at the beginning of each individual section of this Report. **Major findings** are summarised below.

AGRICULTURE

Page 25

- Meaningful assessment of the Department of Agriculture's research performance will require development of benchmarks which enable qualitative assessments of its contributions towards enhanced and sustainable agricultural industries.
Paras 3.1.22 to 3.1.26
- The Parliament should be adequately informed by the Department of all subsidies provided by way of incentive to attract funding from commercial research clients.
Paras 3.1.59 to 3.1.63
- The operating profit of \$16.1 million reported by the Grain Elevators Board for 1992-93 was the best financial result in the Board's 58 year history.
Para. 3.1.85

ARTS, SPORT AND TOURISM

Page 49

- The Victorian Arts Centre Trust needs to ensure that its business plan, currently under development, adequately addresses emerging opportunities within the performing arts industry and facilitates qualitative assessments of the Trust's contribution to cultural and arts development.
Paras 3.2.23 to 3.2.25
- A long standing policy of non-allocation of significant levels of indirect overhead expenses (almost \$10 million in 1992-93) to individual operating units has impeded decision-making of the Victorian Arts Centre Trust and led to incomplete accountability to the Parliament.
Paras 3.2.39 to 3.2.46

ARTS, SPORT AND TOURISM - continued

Page 49

- The growth of the gaming industry has continued during 1993-94 with aggregate turnover of \$4.7 billion generated to 12 March 1994 and turnover for the year likely to be in excess of \$6 billion.
Paras 3.2.126 to 3.2.131
- Notwithstanding the significance accorded by the gaming legislation to research relating to the social impact of gambling, only \$13 000, out of a total available amount of \$6.7 million, was applied from the Community Support Fund for this purpose during 1992-93.
Paras 3.2.135 to 3.2.138
- At the date of preparation of this Report, the total amount of \$7.8 million approved as the initial distribution from the Community Support Fund for 1993-94 had not been drawn from the Fund.
Paras 3.2.139 to 3.2.141
- The Government needs to ensure that periodic allocations from the Community Support Fund are adequately co-ordinated and that resultant outcomes, measured against appropriate benchmarks, are regularly reported to the Parliament and the community.
Paras 3.2.142 to 3.2.144
- Significant changes in management strategies at the TAB resulted in the inclusion within its 1992-93 financial statements of abnormal expense adjustments totalling \$96 million.
Paras 3.2.149 to 3.2.178

BUSINESS AND EMPLOYMENT

Page 85

- The Occupational Health and Safety Authority's workplace inspection program relating to targeted industries and activities was not based on a sound risk-based planning framework.
Paras 3.3.17 to 3.3.22
- As information developed by the Occupational Health and Safety Authority relating to workplace health and safety standards was not widely distributed, employers may not be fully aware of their responsibilities or in a position to effectively identify health and safety problems within their workplaces.
Paras 3.3.23 to 3.3.27
- During 1992-93, the time spent by Occupational Health and Safety Authority inspectors within workplaces only accounted for 26 per cent of the total available days.
Paras 3.3.40 to 3.3.42
- Although the Construction Industry Long Service Leave Board has gradually reduced employer contributions since December 1989 and then waived such contributions in December 1993, the level of surplus net assets has continued to increase and totalled \$144 million at June 1993.
Paras 3.3.64 to 3.3.86
- Government reforms have been successful in redressing the poor financial position of the State's workers' compensation scheme with the Government's key financial objective of a fully-funded position now likely to be achieved within 2 years.
Paras 3.3.93 to 3.3.110

CONSERVATION AND NATURAL RESOURCES

Page 115

- The Melbourne Water Corporation has commenced action to remedy the shortcomings in its cost management procedures under its information technology outsourcing arrangements.
Paras 3.4.27 to 3.4.34
- The Melbourne Water Corporation's recent strategic management initiatives have placed it in a position where it can maximise its benefits from the existing outsourcing partnership while, at the same time, more effectively control its future information technology strategies.
Paras 3.4.35 to 3.4.39
- The State's rural water supply infrastructure is aged and substantial levels of expenditure on asset replacements and maintenance will be required in future years to upgrade its condition.
Paras 3.4.45 to 3.4.55
- Significant early benefits in the form of water savings and controlled releases for environmental purposes have followed completion of the first stage of the Northern Mallee pipeline project.
Paras 3.4.73 to 3.4.79
- The Rural Water Corporation should take action to ensure it is presenting the strongest possible case for future government funding of remaining stages of the Northern Mallee pipeline project.
Paras 3.4.80 to 3.4.87
- Since the appointment of the Royal Botanic Gardens Board in July 1992, substantial progress has been made in meeting the challenges facing the Gardens, including a legacy of insufficient funding and overall development plans, a backlog of essential maintenance and the ageing of flora. The Board needs to build on these achievements in the future.
Paras 3.4.101 to 3.4.149
- Despite the decline in the financial viability and liquidity of the Victorian Institute of Marine Sciences since 1991, little positive action was taken to address this situation until September 1993. A major factor in the progressive deterioration in the financial viability of the Institute since 1991 was the excessive size of its Council with 24 members, and its failure to hold regular meetings to strategically direct and monitor operations.
Paras 3.4.161 to 3.4.182

EDUCATION

Page 163

- The lack of integration between existing systems within the Directorate of School Education has resulted in duplicate and often inconsistent personnel and payroll information leading to confusion, inaccuracies and inefficiencies.
Paras 3.5.37 to 3.5.38
- The Directorate of School Education has appointed external consultants to assist in the evaluation and selection of a replacement personnel/payroll system.
Para. 3.5.42

ENERGY AND MINERALS

Page 187

- After protracted negotiations extending over 4 years to determine the most suitable building for the Gas and Fuel Corporation head office requirements, the Corporation repudiated the agreement to lease a building which was to be constructed specifically for the Corporation and may be required to pay compensation for cancellation of the lease. *Paras 3.6.3 to 3.6.13*
- Based on construction costs, the sale of the Loy Yang B power station by the SECV resulted in a deficiency of \$402 million to the Commission. This deficiency will be recouped by the Commission purchasing electricity at a reduced tariff over the 33 year operating life of Loy Yang B. *Para. 3.6.27*
- The purchasers of Loy Yang B and the financiers enjoy the benefits of a government guarantee covering the performance of certain obligations which the Commission has to fulfil, such as the completion of construction of Loy Yang B and the purchase of power produced by the station. *Paras 3.6.46 to 3.6.53*
- Substantial restructuring of the Victorian electricity supply industry took place in October 1993, with further disaggregation of the industry proposed from 1 July 1994. The Government expects the restructuring of the power industry to increase competitiveness and efficiency. *Paras 3.6.80 to 3.6.85*
- The State Electricity Commission of Victoria (SECV), in recognising as early as 1991 the need to improve its efficiency and reduce costs, has been at the forefront within the public sector in outsourcing many of its activities, with outsourcing contracts valued at in excess of \$554 million at November 1993. *Para. 3.6.104*
- Outsourcing activities have been implemented by the SECV with minimal industrial unrest due largely, in audit opinion, to financial incentives in certain outsourcing contracts relating to the employment of ex-SECV staff, minimum work guarantees, compensation for idle resources and payments to contractors for any future redundancy costs which may arise. *Paras 3.6.174 to 3.6.177*
- The costs associated with the continuing employment of surplus SECV employees are adversely impacting on projected outsourcing benefits. *Paras 3.6.188 to 3.6.192*
- In May 1991, the SECV entered into an agreement to lease a new purpose-built head office building for a period of 20 years at a fixed rental of \$32.4 million a year. However, uncertainty surrounds the future occupancy of the building due to the decline in staff numbers and the restructuring of the State's power industry. *Paras 3.6.196 to 3.6.201*

FINANCE

Page 235

- Significant improvements have occurred in departmental cash management since the audit review of this activity in 1984. However, the Department of Finance needs to assess whether more cost-effective banking services would eventuate from publicly tendering for such services. *Paras 3.7.11 and 3.7.16 to 3.7.24*
- The Department of Finance needs to encourage the extended use of electronic funds transfer facilities by departments and initiate appropriate measures for the adoption of these facilities where savings can be achieved. *Paras 3.7.39 to 3.7.45*

HEALTH AND COMMUNITY SERVICES

Page 251

- Despite the fact that \$78 million has been expended on the National Campaign Against Drug Abuse program in Victoria between 1985 and 1993, there has been no assessment of the effectiveness of the program on producing tangible improvements in the lives of those affected by alcohol and drug related problems. *Paras 3.8.8 and 3.8.15*
- The Department of Health and Community Services had failed to establish a mechanism whereby it could be assured that quality alcohol and drug services, as outlined in its Code of Practice, were available to all clients. *Paras 3.8.48 to 3.8.55*
- The planning, implementation and monitoring processes employed by the Department during the closure of the Caloola Training Centre were effective in ensuring that the de-commissioning of the Centre occurred within the desired time frame and budget. *Paras 3.8.117 to 3.8.120*
- The Department has not introduced ongoing global monitoring procedures to assess the effectiveness of the relocation of Caloola clients into the community and the long-term impact of de-institutionalisation on both clients and the community. *Paras 3.8.121 to 3.8.128*
- The Department has not formulated a long-term strategic capital works plan for the ongoing development of hospital infrastructure to meet the community's future health service needs, despite 2 departmental reviews in the mid-1980s recommending that such a strategy be developed. *Paras 3.8.156 to 3.8.165*
- There was scope to reduce the number of acute beds in the public and private hospital systems by 1 119 beds. In addition, there was surplus space and under-utilised facilities within the existing public hospital infrastructure. *Paras 3.8.173 to 3.8.189*
- There is likely to be an additional oversupply of acute bed facilities in the northern metropolitan area if the development of an acute public hospital at Epping proceeds, or the Heidelberg Repatriation Hospital is integrated into the State system. *Paras 3.8.194 to 3.8.203*
- At June 1993, 37 of the 51 country public hospitals previously recommended for merger or role conversion remain as stand-alone acute hospital facilities. *Paras 3.8.205 to 3.8.212*

JUSTICE

Page 305

- In addition to the \$131.7 million due to the State in uncollected fines, an amount of \$61.2 million is outstanding in respect of infringement notices issued by local government. *Para. 3.9.30*
- Unless the Sheriff is provided with increased enforcement options for the execution of warrants, the level of uncollected fines will continue to grow. *Paras 3.9.35 to 3.9.37*
- Location of offenders is an ongoing problem with 58 per cent of all warrants being returned unexecuted due to the absence of a reliable database to identify the whereabouts of offenders. *Paras 3.9.45 to 3.9.47*

PLANNING AND DEVELOPMENT**Page 321**

- Due to the need to provide interest subsidies and the escalating level of doubtful debts, the State has contributed \$34.1 million to the Home Opportunity Loan Scheme (HOLS) as at December 1993.
Paras 3.10.13 to 3.10.15
- During 1994, the Department of Planning and Development will increase the amount set aside to meet any future cash flow difficulties that HOLS may encounter to \$101 million.
Paras 3.10.16 and 3.10.33
- The total number of HOLS loans in arrears and those subject to special repayment arrangements represented 11.3 per cent of the Scheme's total loan portfolio, or 1 400 loans.
Paras 3.10.25 to 3.10.27
- Due to HOLS non-competitiveness and the high fixed cost of its debt, the Government in January 1994 announced its intention to restructure the Scheme. It was estimated that the restructure will reduce the call on funds set aside by the Department by \$21 million.
Paras 3.10.28 to 3.10.34
- The limited monitoring currently being exercised by the Government in respect of municipal enterprise projects does not adequately identify potential risks.
Para. 3.10.51
- To ensure that a joint venture residential housing project known as *The Mews* proceeded, the Urban Land Authority substantially accepted responsibility for the financial risks of the project without any adjustment for a greater share of profits from the project.
Paras 3.10.59 to 3.10.65
- The overall financial result for the Urban Land Authority from participation in *The Mews* joint venture project is anticipated to be a marginal net return of around \$100 000 even though the Authority's contribution comprised the development sites and related costs of \$1.7 million and \$600 000, respectively, and a guarantee to the developer's financier of \$8.6 million at no cost.
Paras 3.10.66 to 3.10.68

TRANSPORT**Page 343**

- The Department of Transport incurred expenditure of \$229 500 without Tender Board authority.
Paras 3.12.4 to 3.12.7
- Tendering procedures of the Department and the Public Transport Corporation should be improved to ensure that all potential conflicts of interest are avoided.
Paras 3.12.8 to 3.12.19
- No action has been taken to rectify the absence of competitive re-tendering procedures for school bus contracts, a major issue identified 5 years ago by audit.
Paras 3.12.20 to 3.12.36
- The financial ramifications of a lack of action on school bus contracts are substantial, given that the real costs of school bus services have increased by around \$6 million annually since the 1989 audit review.
Paras 3.12.25 to 3.12.27

TRANSPORT - *continued*

Page 343

- The Public Transport Corporation has embarked upon a major reform program which, if successfully implemented, will lessen the financial burden carried by general taxpayers in funding sizeable transport operating deficits.
Paras 3.12.61 to 3.12.70
- Achievement by the Public Transport Corporation of higher patronage levels will be a key prerequisite to sustained improvement in the financial performance of the transport system.
Paras 3.12.71 to 3.12.79
- The Multi-Purpose Taxi Program is by far the largest government scheme of its type in Australia with its participation rate over 50 per cent higher than the combined aggregate number for all other States.
Paras 3.12.117 to 3.12.123
- Membership of the Multi-Purpose Taxi Program has increased from 87 600 in 1989-90 to 123 400 in 1992-93 (an increase of 40 per cent) and annual subsidy costs in real terms have risen from \$10.3 million in 1989-90 to \$17.2 million in 1992-93, an increase of 67 per cent.
Paras 3.12.117 to 3.12.123
- The Multi-Purpose Taxi Program's operational characteristics render it susceptible to fraudulent activity, with a heavy reliance placed on the honesty and integrity of taxi drivers and members.
Paras 3.12.145 to 3.12.158

TREASURER

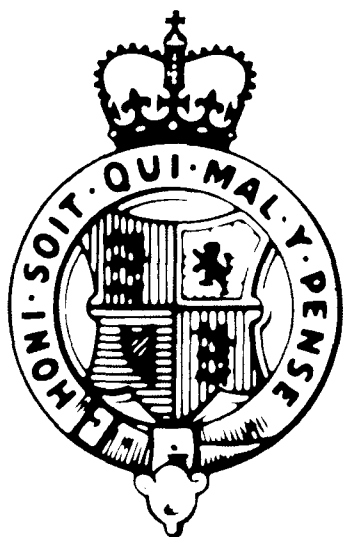
Page 381

- The Transport Accident Commission's strong financial position has been the outcome of a combination of its commendable management performance and the significant contribution of around \$400 per Victorian motorist made to its reserves.
Paras 3.13.9 to 3.13.17
- While, in financial terms, the Transport Accident Commission has forgone income of around \$5.3 million as a result of its buyback offer to holders of Victorian Government Security Bonds, associated with the Farrow collapse, other factors such as the impact on the State's economy should be taken into account when evaluating the merits of the arrangements.
Paras 3.13.18 to 3.13.21
- Although the level of compulsory charges levied on Victorian motorists over the years may be regarded as excessive, taxpayers as a whole are now benefiting from the Transport Accident Commission's financial growth.
Paras 3.13.26 to 3.13.33

BROAD SCOPE ISSUE

Page 391

- The Department of Finance has played a pivotal role in facilitating improvements in the State's financial reporting practices and in improving the timeliness of financial reporting to Ministers and the Parliament.
Paras 4.1.7 to 4.1.15



Part 2

Parliament of Victoria

Part 2

Parliament of Victoria

KEY FINDING
<ul style="list-style-type: none">The audit of the financial statements of the Parliament of Victoria proved satisfactory.

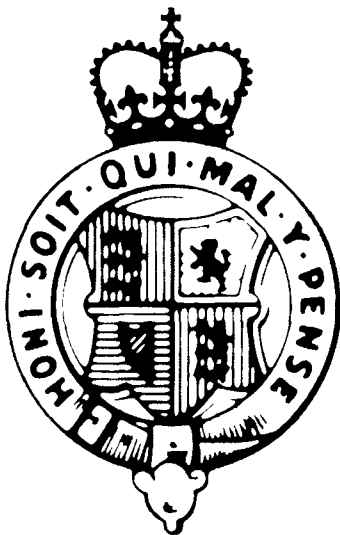
PARLIAMENT OF VICTORIA

**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
MATTERS RESOLVED OR ACTION COMMENCED		
<i>Ministerial Portfolios, May 1992, pp. 28-9. May 1993, p. 23.</i>	Full cost recovery of refreshment rooms and ability to be self-supporting.	The operating result of the Refreshment Rooms improved with the operating deficit being reduced by \$6 500 from the previous year. During the same period, direct and indirect subsidies were reduced by \$19 000.
<i>Ministerial Portfolios, May 1992, pp. 29-30. May 1993, p. 24.</i>	Level of long-term unpaid accounts and efficiency in credit management.	Appropriate action has been taken to improve the collection of moneys due.

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Parliament of Victoria	30 June 1993	No reporting requirements. Audit conducted under <i>Audit Act</i> 1958, s.31.	30 Sept. 1993	30 Sept. 1993
State Parliament Refreshment Rooms	30 June 1993	No reporting requirements. Audit conducted at request of House Committee.	30 Sept. 1993	30 Sept. 1993



Part 3

Audit of Ministerial Portfolios

Part 3.1

Agriculture

KEY FINDINGS

DEPARTMENT OF AGRICULTURE

Management of research activities

- The research activities of the Department of Agriculture are highly sophisticated and of major significance in the achievement of enhanced productivity from the State's agricultural industries.
Paras 3.1.11 and 3.1.50 to 3.1.52
- The Department has recently developed a strategic management framework, with a strong industry focus, to complement its high standing in the scientific research field.
Paras 3.1.16 to 3.1.21
- Meaningful assessment of the Department's research performance will require development of benchmarks which enable qualitative assessments of its contributions towards enhanced and sustainable agricultural industries.
Paras 3.1.22 to 3.1.26
- The Parliament should be adequately informed by the Department of all subsidies provided by way of incentive to attract funding from commercial research clients.
Paras 3.1.59 to 3.1.63
- The Department is moving to resolve past problems with its management information systems which have hindered its decision-making and monitoring of research resources.
Paras 3.1.70 to 3.1.75

GRAIN ELEVATORS BOARD

Improvement in financial position

- The operating profit of \$16.1 million reported by the Grain Elevators Board for 1992-93 was the best financial result in the Board's 58 year history.
Para. 3.1.85

3.1.1 The Minister for Agriculture has responsibility for operations within the Agriculture sector. Details of the specific ministerial responsibility for public bodies within the Agriculture sector are listed in Table 3.1A. These public bodies, together with the Department of Agriculture, are subject to audit by the Auditor-General.

**TABLE 3.1A
MINISTERIAL RESPONSIBILITY WITHIN THE AGRICULTURE SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Agriculture	Daratech Pty Ltd Grain Elevators Board Melbourne Market Authority Murray Valley Citrus Marketing Board Northern Victorian Fresh Tomato Industry Development Committee Tobacco Leaf Marketing Board Victorian Dairy Industry Authority Victorian Dried Fruits Board Victorian Egg Marketing Board (a) Victorian Meat Authority (b) Victorian Strawberry Industry Development Committee

(a) Ceased operations from 12 June 1993.

(b) Audit responsibility commenced on 1 July 1993.

3.1.2 Comment on matters of significance arising from the audit of certain of the above entities is provided below.

DEPARTMENT OF AGRICULTURE

MANAGEMENT OF RESEARCH ACTIVITIES

Background

3.1.3 The Department of Agriculture is the Government's principal agency for the delivery of services to enhance the competitiveness and productivity of Victoria's agricultural industries. One of the Department's key responsibilities is research which is directed at developing new and improved methods of agricultural production and food processing in plant and animal breeding, animal husbandry and soil cultivation practices.

3.1.4 Total departmental expenditure for 1992-93 was \$124 million. While the Department does not separately record expenditure on research, **it has estimated that such activities accounted for around \$53 million or 45 per cent of its total outlays in 1992-93.** Of this amount, rural industry research corporations (Commonwealth and industry-funded research bodies) contributed \$12.5 million, Daratech Pty Ltd (through which commercial funding for research is managed) \$2.6 million, the Commonwealth Government \$1.3 million, with the balance of \$36.6 million provided by the State Government.

3.1.5 Over a number of years, the Department has established a national and world-class standing in respect of research projects undertaken by its scientific staff. The Department is currently involved with several large projects relating to the development of controlled-release herbicides and insecticides, including a highly significant project dealing with animal vaccines for the control of liver fluke parasites. These research projects have world-wide economic and environmental implications and have attracted commercial funding via Daratech from national and international sources.

3.1.6 At the time of the audit review, the Department was involved with the administration of about 300 scientific projects undertaken at its 19 research centres across the State. The Department employs around 1 700 personnel and it estimates that, of this figure, about 700 are involved in research activities on an ongoing basis.

3.1.7 Late in 1993, the Department revised its management structure for its research activities to facilitate a focus on 12 industry programs which relate to the State's main agricultural industries. These industry programs include the dairy, horticulture, meat, grains, wool, poultry, pigs, grapes and wine, and food processing industries.

3.1.8 According to Australian Bureau of Statistics data relating to 1992-93, Victorian agricultural production (not including food processing) was valued at \$5.1 billion and represented 24 per cent of Australia's total agricultural production in that year. Table 3.1B illustrates this position.

**TABLE 3.1B
VALUE OF VICTORIAN AGRICULTURAL PRODUCTION
RELATIVE TO AGGREGATE AUSTRALIAN VALUE, 1992-93**

<i>Agriculture industry</i>	<i>Victoria</i>	<i>Australia</i>	<i>Victorian component of total Australian value</i>
	(\$m)	(\$m)	(%)
Dairy	1 184	2 115	56
Horticulture	946	2 828	33
Meat	875	4 497	19
Grains	762	4 627	16
Wool	522	2 681	19
Poultry	286	1 091	26
Pigs	187	664	28
All other crops	317	3 043	10
Gross value	5 079	21 546	24

3.1.9 The significance of the State's agricultural production is reinforced by the fact that the food processing industry, which is the largest manufacturing industry in Victoria (accounting for around 20 per cent of manufacturing turnover), is heavily dependent on the efficiency of agricultural production to maintain its competitiveness. Information compiled by the Department showed **that agricultural production and food processing industries collectively represent the largest export sector of the Victorian economy, with a value for 1992-93 of \$3.5 billion or 40 per cent of the State's export earnings.**

3.1.10 During the year, audit carried out a review to assess the effectiveness of strategies, information systems and other procedures utilised by the Department in the management of its research activities.

OVERALL CONCLUSION

3.1.11 The research activities of the Department of Agriculture are highly sophisticated and are of major significance in terms of achievement of productivity and quality enhancements to the State's agricultural industries. The Department's performance in research has earned it national and international recognition.

3.1.12 The Department has recently developed a strategic management framework, with a strong industry focus, to complement its high standing in the scientific research field. A key measure of its effectiveness over the coming years will be the extent to which it utilises this framework to achieve further advancements in the quality of its research outcomes.

3.1.13 Because of the importance of service delivery to research clients, audit conducted a survey of rural industry research corporations (which represent the Department's main source of external research funding) to obtain their views of the Department's research performance. The survey results were generally supportive of the Department's performance. However, some matters were identified which require remedial action, particularly in terms of improvements to the quality and timeliness of final research reports and better alignment of its research direction with industry assessments of areas of emerging significance.

3.1.14 Substantial levels of costs (at least \$600 000 over the 18 month period to December 1993) are not recovered by the Department from commercial research clients when compared with cost recovery guidelines issued by the Department of the Treasury. The Department's commercial research environment requires it to attract contributions from external parties to projects with potential royalty opportunities and, often, agreed contributions may be based on an assessed level of costs rather than total costs. The magnitude of unrecovered costs reinforces the importance of the Department ensuring that all departures from Treasury guidelines are fully justified. In addition, particulars of any subsidies provided by way of incentive to external parties should be periodically communicated to the Parliament.

3.1.15 For many years, the Department has experienced problems with its management information systems which were further confirmed during the audit. These problems have led to the production of incomplete and unreliable information which has hindered decision-making and the monitoring of research resources. The Department is about to commission a new project information system which it expects will substantially upgrade its capacity to effectively oversee the management of resources utilised in research activities.

Strategic management framework

3.1.16 The major objective of the Government's agricultural policy relating to research is to improve agriculture as a long-term contributor to the economy of Victoria. The policy stresses the importance of ongoing research into markets for agricultural products, farming practices and new technology so that enhanced scientific expertise and improved research quality can improve productivity in priority agricultural areas.

Development of 1993 corporate plan

3.1.17 In order to facilitate achievement of the Government's policy objectives relating to research, the Department finalised a detailed corporate plan in December 1993 covering the period to June 1995. The Department's mission statement embodied in the corporate plan is expressed as follows:

"The staff of the Department of Agriculture are committed to improving the economic growth and sustainability of agriculture in Victoria through effective science-based programs."

3.1.18 The corporate plan includes 4 high-level goals relating to productivity, industry development, market development and sustainability of agricultural production, and identifies 3 key strategies as the principal means of achievement of its overall mission during the planning period. These strategies are summarised as follows:

- adoption of an integrated and multi-disciplinary management approach aligned to each major agricultural industry;
- establishment of ongoing planning and review processes to monitor programs and their outcomes to ensure maximum cost-benefit; and
- implementation of guiding principles, such as improved scientific expertise, effective program delivery systems, and research programs linked to outcomes and industry needs.

3.1.19 The Department aims to achieve these strategic goals by focusing its research services through 12 industry programs which are aligned to the State's major agricultural industries. Each program has been developed in consultation with industry representatives and identifies needs and priorities for resourcing based on areas of greatest economic impact. For example, in the dairy industry program, the Department has determined that resources need to be redirected from disease control to animal genetics, pasture improvement and utilisation, as these areas offer the greatest potential for increased productivity.

3.1.20 The Department is currently moving, from a previously regional emphasis, to align research activities with industry programs. The Department considers that the industry programs are essential to ensuring the relevance of its research activities to the needs of the agricultural sector. In this context, the programs are designed to assist in maximising the rate of economic growth and the competitiveness of agriculture in Victoria.

3.1.21 The Department is commended for establishing a corporate plan which embodies a strategic direction with a clear industry focus. It now has the important challenge of ensuring that this strategic planning framework is managed effectively as it pursues its research objectives.

□ RESPONSE provided by Secretary, Department of Agriculture

The Department is moving rapidly to adjust its organisational structures and budget processes to meet the requirements of implementing its strategic plan.

Importance of performance reporting

3.1.22 The development of quantitative and qualitative performance measures appropriate to the Department's research environment will be an important prerequisite to enabling the Department to meaningfully assess progress towards achievement of strategic goals. The significance of such measures extends beyond the Department's internal decision-making processes to also encompass the discharge of its accountability obligations to the Parliament in terms of research performance.

3.1.23 Although, as previously mentioned, the Department has earned national and international recognition in respect of its research achievements, the audit review found that it does not specifically maintain information, critical to periodic assessment of research performance on the status, costs, economic benefits and outcomes relating to research projects either on an individual or global basis. This situation has been principally due to:

- the absence of a corporate plan in recent years to articulate its research objectives and key strategies (the previous corporate plan expired during 1990);
- poor information systems restricting the Department's ability to undertake regular assessment and monitoring of research activities; and
- a lack of performance indicators to periodically monitor progress against research goals.

3.1.24 It was pleasing to find that, at the time of the audit review, the Department was in the process of developing detailed business plans which will incorporate specific performance indicators for measuring progress towards its strategic goals. The Department expects to be in a position to provide the Government with a detailed report on its performance by December 1994.

3.1.25 In discussions with the Department, audit stressed the value of aligning its performance benchmarks with the macro goals embodied in the Government's agricultural policy relating to research and with qualitative assessments of its contributions towards enhanced and sustainable agricultural industries and the needs of research funding providers.

3.1.26 **Similar to the position relating to its corporate plan, the Department is in the early stages of developing a structured performance measurement and monitoring framework for its research activities. This framework, when finalised, should assist the Department in systematically evaluating the efficiency and effectiveness of its research performance and progressively communicating the results to the Parliament and the community.**

Additional initiatives taken by the Department

3.1.27 In addition to finalising a corporate plan and developing indicators for the assessment of its research performance, the Department has implemented several important initiatives in recent years which have been aimed at further strengthening its overall research capability. These initiatives have included:

- Establishment of a new organisational unit, the Division of the Chief Scientist, to co-ordinate the development and implementation of research activities and provide a central liaison point for industry. This Division has become the key centre within the Department for the strategic co-ordination and control of research.
- Rationalisation, via amalgamations and closures, of research centres as part of the Department's strategy to more effectively focus research on specific industry programs.

- Appointment of industry co-ordinators and specialist teams for the 12 main industry programs. These teams have held planning workshops with representatives of their industry, including funding organisations and departmental staff. The workshops have developed 5 year program plans which define priority areas, objectives and related resource requirements.
- Establishment of strategic alliances, including joint ventures with other research bodies such as universities, the CSIRO and government agricultural bodies in other States to enhance research programs. These alliances have led to improved efficiencies through the co-location with other parties of research facilities such as:
 - The CSIRO's dairy technology facility with the Department's Food Research Institute at Werribee (which has been designated by the Commonwealth as a Co-operative Research Centre) under a joint venture also involving 2 universities;
 - Establishment of a program known as *Riverlink* under which the previously-separated research activities of the CSIRO, the South Australian and New South Wales Departments of Agriculture and the Department have been systematically co-ordinated. This program is designed to cover research on citrus, wine and grapes, and dried fruits and the co-ordination of research effort by the participating bodies to maximise research outputs; and
 - An agreement reached with the University of Melbourne for the co-location of its pig research unit at Mt Derrimut with the Department's equivalent research facility situated at Werribee.
- The development of a *Code of Ethics for the Conduct of Scientific Research* which provides guidance to departmental scientists on professional standards and other issues such as ownership of intellectual property and commercial confidentiality. All scientists entering into an employment agreement with the Department are required to formally acknowledge that they will follow the code of ethics in the discharge of their research responsibilities.

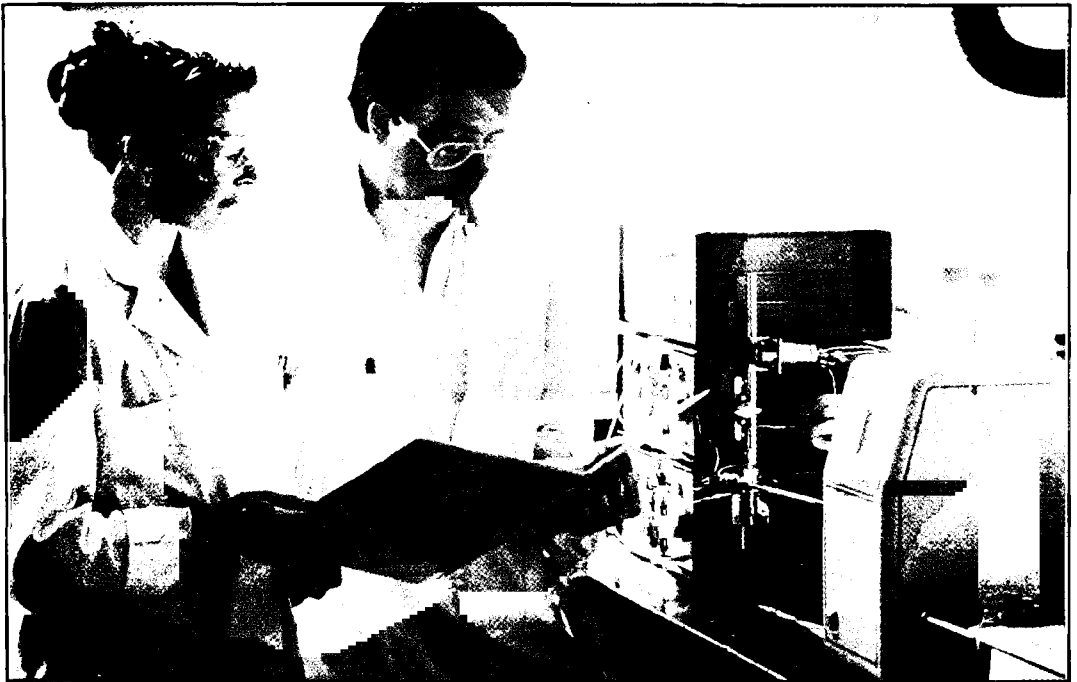
3.1.28 These strategic initiatives constitute positive developments which the Department expects will contribute to more efficient and effective management of its research activities.

Service delivery to research clients

3.1.29 The principal research clients of the Department are the rural industry research corporations, Daratech Pty Ltd and the Commonwealth Government.

3.1.30 During 1992-93, the Department was involved in around 270 research projects on behalf of the rural industry research corporations with related funding of \$12.5 million, representing around 67 per cent of the total external research funding for the year.

3.1.31 Each year the Department, in competition with other government and private research organisations, submits a range of project proposals to the research corporations for their funding consideration. Audit was advised by the Department that evaluative criteria utilised by the research corporations in reaching decisions on funding allocations across Australia include previous client relationships and performance including service delivery.



Research facilities at the Department of Agriculture.

3.1.32 Some measure of the increasing significance of research funding provided to the Department by the research corporations can be derived from the fact that, in 1993-94, the Department will receive \$14.6 million or almost 7 per cent of the total national funding provided by these organisations, compared with \$9.8 million or about 5 per cent in 1989-90. **To have attracted additional funding in what is a highly competitive environment is a significant achievement by the Department, particularly in light of the Government's budgetary constraints and a reduction of about 20 per cent in the number of scientific staff over the same period.**

□ RESPONSE *provided by Secretary, Department of Agriculture*

The Department records that its effectiveness to continue to maintain a high level of external research funding is dependent upon its ability to continue to maintain an outstandingly qualified core of State-funded staff in key areas. Maintaining this capacity is dependent on the Department being able to offer competitive, performance-based salaries and salary packaging to match those offered by other research and development organisations.

3.1.33 In order to assess the Department's performance in the delivery of research services to research corporations, audit conducted a survey of all 12 corporations involved in the provision of funding to the Department. The major element of the survey involved completion by the corporations of an audit questionnaire covering the following key areas:

- overall performance of the Department in carrying out research relative to other government agricultural research organisations throughout Australia;
- impact of the departure of departmental employees on research projects;
- whether there were any concerns or suggestions for improvement in respect of the Department's management of research activities;
- adequacy of the communication processes relative to other government agricultural research organisations throughout Australia; and
- whether the priorities of particular industries were adequately addressed.

3.1.34 The audit assessment of the quality of the Department's service delivery to research corporations also included examination of relevant departmental documentation, discussions with scientists in respect of particular research projects and further liaison, as necessary, with the research corporations. The results of the survey have been discussed in detail with departmental representatives and some of the more significant issues are summarised in the following paragraphs.

Quality of service delivery

3.1.35 The majority of the research corporations considered that the Department had established a record of good service delivery but indicated that there was scope for further improvement in the following areas:

- need for enhancement in the quality of project submissions and reports;
- greater consistency in the quality of research undertaken by scientists;
- a need to anticipate potential problems and overcome the necessity to renegotiate contracts when a problem arises; and
- prompt advice of staffing changes affecting funded projects.

3.1.36 The research corporations also indicated that timeliness of completion of research was adversely affected by departures of key scientists. This situation also had an adverse impact on the continuity and quality of research projects.

3.1.37 In discussions with the Department on the quality of its service delivery, audit was advised that the matters raised by the corporations would be carefully examined and any necessary remedial action taken without delay.

3.1.38 **Although the Department had, at the time of the review, taken steps to upgrade the quality of its submissions to research corporations, the results of the survey indicate that further action may be necessary to improve service delivery to clients.**

□ RESPONSE provided by Secretary, Department of Agriculture

The Department accepts that client service delivery is an area requiring continuous improvement and has already implemented steps to achieve this, based on its industry program focus.

Research performance obligations

3.1.39 Contracts between the Department and the corporations for research projects usually require the Department to periodically report on performance against specific milestones, such as timelines, for the completion of fieldwork or of specified experiments. These milestones constitute an important control measure for timely completion of specific elements of research.

3.1.40 The audit analysis of survey responses and other documentation held by the Department indicated that the Department's record in meeting milestones was poor. Specific problems identified through the survey included:

- Milestones in more than 15 per cent of all projects undertaken had not been met; and
- Substantial delays were experienced by the Department in issuing final reports to the corporations at the completion of projects. In some instances, delays in excess of 12 months had occurred in the provision of final reports.

3.1.41 In the absence of remedial action, a failure to meet contractual obligations established with the corporations has the potential to damage the Department's reputation for provision of reliable service. In addition, untimely reporting could delay the application of important research results to industry.

3.1.42 **The Department should take corrective action to ensure that key milestones set for projects are met and final reports on research outcomes are delivered to the corporations in accordance with agreed timeframes.**

□ *RESPONSE provided by Secretary, Department of Agriculture*

The Department has put appropriate procedural mechanisms in place and is also working through work performance planning and evaluation to improve officers' compliance with contractual obligations.

Increased emphasis on client relationships

3.1.43 Audit analysis of the survey responses indicated that the corporations had welcomed initiatives which had been taken by the Division of the Chief Scientist to improve client relationships. Favourable references were made to the Department's appointment of industry co-ordinators, the development of plans in consultation with industry personnel and the Department's move towards more collaborative projects with other research bodies.

3.1.44 Overall, the audit survey found that the initiatives of the Department in actively promoting good client service and communications were having a positive effect on the research corporations. **It will be important for the Department to ensure that the benefits of sound client relationships for its research activities continue to be reinforced.**

Meeting industry priorities

3.1.45 There was a mixed response from the research corporations in terms of whether they considered submissions for research funding from the Department were consistent with their assessment of priority areas for research. Some corporations indicated that more projects would be funded if the Department's current research direction was more in line with their priorities.

3.1.46 Late in 1993, as part of its strategic initiative to focus its research more in line with specific industry groups, the Department sought input from industry bodies (including the research corporations) through planning workshops to gather information on industry priorities with a view to ensuring that its research direction had greater compatibility with industry needs. Through this initiative, the Department has, for the first time, commenced development of industry strategic plans which are designed to improve the focus of its research. Although most of these plans are currently still under development, **audit considered that they have the potential to improve the relevance of the Department's research activities from the viewpoint of funding providers.**

Future industry directions in research

3.1.47 The analysis of survey results disclosed that some industry bodies have expressed concerns on the ability of the Department to accommodate the emerging significance within their industries of *post-farmgate* research (research involving subject matters beyond the boundaries of farm production). Examples of post-farmgate research include the analysis of past international markets and their likely future directions and research significance. Much of this type of research is non-scientific in nature.

3.1.48 As previously mentioned, the Department's mission statement focuses on improving the economic growth and sustainability of agriculture in Victoria "... *through effective science-based programs*". This mission reinforces the Department's specific emphasis on scientific research. Responses to the audit survey specifically indicated that many industry bodies are placing increasing significance on post-farmgate research. For example, during 1993-94, the Meat Research Corporation has allocated approximately 49 per cent of its total funding for the year to this category. In this respect, the main priority areas identified by that Corporation relate to consumers' needs and effective marketing. One of the research projects allocated under this program involved *improving beef product positioning and total carcass utilisation* in Japan. The Department acknowledged in discussions with audit that it currently has a limited research capability in these emerging areas.

3.1.49 **The increasing emphasis placed by research corporations on post-farmgate research could have long-term ramifications for the Department's science-based research programs. In order to remain responsive to the future needs of industry, the Department needs to assess whether a post farm-gate research capability should be developed.**

□ **RESPONSE** provided by Secretary, Department of Agriculture

The Department is aware of this issue and is addressing it through re-evaluation of its core business and skills base.

Management of research projects

3.1.50 At the time of the audit review, the Department was involved with the administration of around 300 scientific research projects undertaken at its 19 research centres across the State. The audit review encompassed an assessment of strategies followed by the Department in the ongoing management and control of projects.

3.1.51 During visits to research centres, audit soon became conscious of the wide diversity and advanced sophistication of research projects within the Department. Some of the more significant projects underway at that time are summarised below:

- The Department, in collaboration with Daratech, Monash University and 2 private sector companies, now operates the world's largest controlled-release technology program in agriculture in respect of environmentally-friendly herbicides and insecticides. This program uses the Department's biological expertise and testing facilities at Kyabram, Knoxfield and Horsham.
- At the Department's Institute of Animal Sciences at Attwood, a vaccine is under development against liver fluke parasites which, in affected animals, are responsible for declines of around 20 per cent in wool growth, milk yield and livestock growth rates. The research group has identified molecular components of the parasite that have potential as a vaccine. These components were obtained by genetic engineering techniques and have been tested in field trials in Australia and overseas.
- Working with several major private sector companies, the Department's Institute of Horticultural Development at Knoxfield has developed specialised packaging film for fruit and vegetables. This film, which can be used for domestic and export markets, creates a modified atmosphere around the produce to extend shelf life and reduce invasion by decay-causing organisms.
- The Department's Institute of Sustainable Irrigated Agriculture at Tatura has received funding from fruit canneries to breed white-fleshed canning peaches to meet the specific requirements of Asian markets. Yellow-fleshed canning peaches familiar to Australian consumers are not popular in Asian markets, particularly in Japan.

- At the Institute of Animal Sciences, a research team has developed a world-leading technique involving the use of DNA fingerprinting (gene identification) for the verification of pedigree in a variety of animal species. This technique was recently introduced by the Australian Harness Racing Council. The Department expects that the facility will be used by other societies involved in the registration of livestock.

3.1.52 The above sample of projects illustrates the wide ranging economic and environmental significance of the Department's research projects. The involvement in projects of such magnitude and sophistication has been instrumental in building the Department's national and international standing in the scientific research field.



Research into the development of peaches for the Asian markets.

Key elements of research project management

3.1.53 As previously indicated, the Division of the Chief Scientist has prime responsibility for the development, co-ordination and implementation of research policies and project management procedures within the Department. Under the overview of that Division and the Department's Operations and Corporate Services Division, individual research projects are managed and controlled by project leaders, who report to the Directors of the Department's 19 decentralised research centres.

3.1.54 Scientific research is clearly a complex activity which needs to be complemented by sound project management practices. During the review, audit assessed the extent to which the framework established by the Department for the management of individual projects was conducive to effective delivery of research services.

3.1.55 **Audit concluded from this assessment that the Department had substantially improved its management of projects over the last 18 months.** Audit has conveyed to the Department a number of suggestions for further enhancing the quality of its management practices. A summary of the audit suggestions is set out below.

Contractual arrangements

3.1.56 Departmental policy instructions require that a formal contract be established for every research project involving an external party. The policy statement recognises that such contracts are important to establish the rights, responsibilities and obligations of all participating parties. To assist in minimising subsequent disputes and uncertainties, contractual agreements should ideally be negotiated and signed by the parties before commencement of research work.

3.1.57 An examination by audit of contracts established by the Department with its principal client groups found that:

- The Department, generally entered into comprehensive formal agreements with the rural industry research corporations for the execution of individual research projects. These contracts were usually well-prepared and outlined each party's responsibilities, funding obligations and rights to intellectual property. However, the effectiveness of these arrangements was limited in that the signing of contractual agreements by the Department and the corporations often occurred up to 6 months after projects had actually commenced.
- Arrangements entered into with commercial clients generally took the form of an exchange of correspondence rather than formal contracts. Often the correspondence between the parties did not clearly set out the key operating terms and conditions. In the absence of formal contracts, the Department's position could be weakened in the event of a dispute between the parties which could hinder potential cost recovery action.
- In several instances, contractual arrangements for collaborative projects with Daratech (these projects are jointly funded by the 2 bodies) had not been finalised prior to commencement of projects. **One significant example identified by audit during the review involved a 1988 project for which the Department had incurred expenditure in excess of \$1 million up to 30 June 1993. A dispute with Daratech over respective intellectual property rights had resulted in the contract remaining unsigned, and resolution of the dispute had not been reached at the date of preparation of this Report.** In addition, contractual agreements which were required under departmental guidelines to be updated annually to reflect changes in equity shares, had often not been renegotiated.

3.1.58 **In order to minimise the risk of dispute and potential for damages, the Department should take steps to ensure that all contractual arrangements with external parties are formalised before commencement of projects.**

Full cost recovery on commercial projects

3.1.59 Under guidelines issued by the Department of the Treasury for the setting of fees and charges, the Department is required to recover all costs associated with undertaking commercial activities.

3.1.60 In the 18 month period to December 1993, the Department charged commercial clients a total of \$4.2 million for research work. This amount was less than the total costs which should have been recovered under the Treasury guidelines. An examination by audit of a selection of research projects indicated that costs not recovered by the Department during this 18 month period amounted to at least \$600 000.

3.1.61 In discussions with audit on this issue, the Department outlined the difficulties it faced with full application of the Treasury guidelines to the commercial research environment. It explained that this environment is characterised by a regular need to attract contributions by external parties to research projects with potential royalty opportunities. Often, negotiations and final decisions by the Department will reflect the commercial reality of particular projects under which agreed contributions from external parties and their related royalty returns may be based on an assessed level of costs rather than total costs.

3.1.62 Given the above circumstances and the magnitude of unrecovered costs identified by audit, it is important that the Department ensures that all departures from Treasury guidelines are fully justified. It is also important that the Department adequately informs the Parliament of its cost recovery procedures in the commercial research field, including information on the extent to which the participation by external parties on particular projects has been assisted through some form of subsidisation.

3.1.63 In December 1993, the Department moved to update its policy instruction on cost recovery and varied the approach followed for calculation of costs to be recovered from commercial clients, to ensure greater consistency with Treasury guidelines.

□ RESPONSE provided by Secretary, Department of Agriculture

The Department of Agriculture wishes to place on record that generally its current cost recovery procedures are achieving the following recoveries of salaries (170 per cent), travel costs (200 per cent) and operating costs (120 per cent). In the 3 major projects which account for \$500 000 of the "deficit" reported here, the Department of Agriculture recovered 170 per cent for salaries but negotiated not to mark-up travel and operating components in recognition of the significant potential returns to the Department from equity in intellectual property.

The Department of Agriculture also records that approximately half of the revenue from commercial clients was received as the client's share of collaborations in which the Department and its commercial partners share equity in proportion to their actual financial contributions; cost sharing rather than cost recovery has been the objective. The Department has made strenuous efforts to ensure that no State funds are expended to subsidise commercial clients.

The Department of Agriculture's specific methodology has been supported by Treasury officers as more advanced than other Departments.

Notwithstanding these comments, the Department of Agriculture accepts the application of costing principles can be improved in some instances and commissioned its own review in 1993.

The Department has promulgated Treasury guidelines and agrees that there is an ongoing need to monitor and improve commercial practices.

Peer review processes for research projects

3.1.64 A peer review process constitutes an important element of quality assurance mechanisms in place in the research arena. Effective peer review processes enable management practices to be independently evaluated in terms of the adequacy of scientific methodologies and adherence to contractual obligations and timelines.

3.1.65 Although a peer review process for its scientific research activities has been endorsed by the Department, little action had been taken to actually implement such a process. The Department has indicated to audit that it intends to utilise an independent scientific peer review on a cyclical basis to augment its existing quality control strategies for research.

□ *RESPONSE provided by Secretary, Department of Agriculture*

The Department has used peer review, including external peer review, to evaluate scientist performance over a long period. Peer review of research projects has proved to be difficult to implement as a result of geographic and time constraints. An effective system needs to be efficient and must avoid degenerating into a bureaucratic process. The Department expects this will be improved through its industry program planning processes.

Absence of research documentation guidelines

3.1.66 Research documentation guidelines are an important management tool used by research organisations to ensure that scientific personnel record details of their methodology, actions and results in a consistent and accurate manner. Properly maintained research records assist with training and the transfer of knowledge, ensure accountability over research work and help to protect intellectual property.

3.1.67 During visits to a number of research centres, audit examined research files maintained by project scientists and found that most scientists were able to demonstrate that their research activities had been adequately documented. However, these visits did highlight inconsistencies in the extent of detail recorded and the absence of evidence to indicate the quality control processes followed by supervisory scientific staff in their review of experimental work undertaken during research.

3.1.68 The Department advised that it relies on the professional training of its scientists to ensure that adequate records of experimental work are maintained. While audit recognises this position, it is important for the Department to ensure its quality standards for research are consistently maintained through adequate documentation.

3.1.69 The Department should consider introduction of documentation guidelines which require scientific staff to develop a systematic evidential trail to substantiate research results.

□ *RESPONSE provided by Secretary, Department of Agriculture*

While the Department has relied on its post-graduate training and Code of Ethics for the Conduct of Scientific Research, it accepts that a more direct approach to documentation may be desirable.

Management information systems

3.1.70 For several years, the Department operated a project management system entitled the Victorian Agricultural Management Information System (VAMIS) which had been consistently criticised by external reviews as ineffective for project management purposes. In particular, VAMIS was found to provide information which was outdated, inaccurate and highly unsuitable for sound decision-making.

3.1.71 VAMIS was decommissioned by the Department in July 1991 and replaced as an interim measure by an upgraded financial management system to fulfil project management needs. This system was intended to enable the matching of quantitative financial data with qualitative information on a project basis and the reporting of research activities at both project and program levels.

3.1.72 The audit review found that this latest system did not provide management with information necessary for effective monitoring of research activities. Of particular concern was the absence of management reports detailing:

- all sources of funding for individual projects and industry programs;
- particulars of costs incurred over the life of the projects;
- aggregate expenditure on research activities at a given point in time across the Department; and
- project expenditure on an industry or program basis.

3.1.73 **Without this information, the Department has not been in a position to effectively overview the planning, monitoring and evaluation of its research activities.**

3.1.74 In addition, audit visits to the major research centres revealed that various microcomputer based systems, utilising both packaged and internally-developed software were in place to overcome the deficiencies of the central information system. These local systems, which were mostly incompatible with the central system, have resulted in substantial duplication of recorded data and human effort.

3.1.75 Given that the Department's problems with unsatisfactory management information systems have been experienced for many years, it was pleasing to find that it commenced action in 1993 to develop a new project information system. **The Department is confident that this system, which is due to become fully operational in May 1994, will overcome its past problems and lead to more effective monitoring of the management of research resources.**

Improvements to research facilities and equipment

3.1.76 The value of the Department's total assets at 30 June 1993 was \$168 million. The majority of these assets constitute research facilities and related equipment which are estimated by the Department to have a value of \$125 million.

3.1.77 The Auditor-General's *Special Report No. 10, Utilisation of Plant and Equipment*, tabled in Parliament in November 1988, identified a number of issues relating to research equipment which required attention by the Department, including failure to dispose of assets which had been retained beyond their useful lives, outdated and inefficient equipment and problems with the disposal of obsolete equipment. A subsequent audit review in 1990 indicated that very little action had been taken by the Department to address these matters.

3.1.78 During the current review, audit evaluated whether the standard of facilities and equipment used for scientific research by the Department had improved and whether past problems previously identified by audit had been rectified.

3.1.79 **Audit was pleased to find that many of the concerns raised in the previous Auditor-General's Reports had been addressed.** Specific departmental actions taken to improve the overall standard of research facilities and equipment included:

- Amalgamation and consolidation of a number of research centres to upgrade the overall standard of research facilities and equipment. This improvement was assisted by Commonwealth capital funding of \$18 million received in 1993-94 for the development of the Department's Food Research Institute at Werribee;
- Substantial reductions in the level of obsolete and unserviceable equipment. These reductions had largely resulted from improved disposal procedures and changes in legislative requirements to allow retention of sale proceeds; and

- Improvements to operating efficiencies resulting from the replacement of outdated scientific equipment. These improvements have followed from increased autonomy to Directors of research centres in the management of budgets which has led to greater operating efficiencies.

3.1.80 The Department has acted positively to upgrade the condition and efficiency of its research facilities and equipment.

Departmental response to 1990 review of agricultural research in Victoria

3.1.81 During 1989, a wide-ranging review of the Department's research functions was undertaken by a Committee chaired by the Hon. Ian Baker MP. The Committee's Report issued in February 1990, entitled *A Review of Agricultural Research in Victoria*, was critical of the management and direction of the Department's research activities.

3.1.82 A summary of the principal recommendations of the review were:

- need for appointment of a Chief Scientist to co-ordinate research activities and develop research strategies;
- establishment within the Department of a small project management unit to oversee the scientific research portfolio and quality control processes (including scientific peer reviews);
- development of a management information system to provide reliable financial and other relevant information for project management; and
- rationalisation of the Department's research infrastructure via a reduction in the number of research centres and an upgrading of the standard of facilities and equipment.

3.1.83 As indicated in earlier paragraphs, the Department has substantially addressed the major recommendations of the 1990 review.

GRAIN ELEVATORS BOARD

IMPROVEMENT IN FINANCIAL POSITION

3.1.84 The Auditor General's *Report on Ministerial Portfolios, May 1992*, commented on the early impact on the Board's operations of the 1989 deregulation of the domestic wheat market. The Report illustrated the major fluctuations in annual operating results of the Board over the 5 year period to September 1991, brought about by highly variable harvest volumes caused by variable grain prices and unpredictable climates. For 1990-91, the Board reported a loss of \$4.2 million due to a poor harvest and a 20 per cent fall in market share, following deregulation. The projected result for 1991-92 at the time was a loss of \$8 million.

3.1.85 Since the May 1992 Report, the financial position of the Board has improved significantly. Although grain receipts for 1991-92 were the lowest since the drought year of 1982-83, the Board managed to report a lower operating loss (\$3 million) for the year than the 1990-91 result. However, **the most dramatic improvement occurred in 1992-93 when the Board generated an operating profit of \$16.1 million, the best financial result in its 58 year history.**

3.1.86 The principal reason for the Board's exceptional performance in 1992-93 was a very sizeable grain harvest which increased the volume of grain received within the Board's system to 3.6 million tonnes from 1.6 million tonnes in 1991-92. The magnitude of this harvest effectively offset, for the year, concern about the Board's excess storage capacity outlined by audit in the May 1992 Report.

3.1.87 The improved financial performance was also influenced by the following 2 strategic initiatives implemented by the Board in recent years:

- *Debt reduction* - under a key management strategy, the Board utilised the favourable 1992-93 financial outcome to reduce its loan obligations by \$17.2 million (representing an additional payment of \$15.2 million over and above scheduled repayments of \$2 million for the year), with interest charges falling by \$2 million during the year; and
- *Staff downsizing* - in 1992-93, the full year impact of earlier actions taken by the Board to reduce permanent staff numbers minimised operating costs for the period. Since September 1991, permanent staff numbers have fallen from 395 to 313 at 30 September 1993.

3.1.88 In view of the loss of market share following deregulation of the grain industry and a dependence on the size of grain harvest in any particular year, the Board intends to progressively broaden its business base beyond the core activities of grain receipt, storage and handling to encompass new products such as woodchips and cement clinker. Amending legislation passed by the Parliament in 1992 provided the authority for this strategic direction and the Board's long-term objective is to generate 25 per cent of its revenue base from non-grain handling activities. In 1992-93, these activities represented about 4 per cent of the revenue base.

3.1.89 With respect to the grain harvest for 1993-94, the Board had received 3.4 million tonnes up to 31 January 1994, **which indicates that the financial result for the year is also likely to be very favourable. The Board's latest estimate of operating profit for the year is \$12 million.**

PROPOSED PRIVATISATION OF THE BOARD

3.1.90 In its 1993-94 *Budget Paper No. 2*, the Government indicated that preparatory work associated with the proposed privatisation of the Board was underway. The detailed consideration of privatisation options and related issues has occurred during 1993-94 under the overview of a government steering committee established in conjunction with the Office of State Owned Enterprises within the Department of the Treasury. The steering committee has been led by a government-appointed chairman and comprises representatives from the Department of the Premier and Cabinet, the Department of Transport, the Department of Agriculture, the Office of State Owned Enterprises and the Board.

3.1.91 The Minister for Agriculture has recently announced that a preliminary target date of 30 September 1994 has been set for privatisation of the Board.

TOBACCO LEAF MARKETING BOARD

DECLINE IN DEMAND FOR TOBACCO

3.1.92 Under its enabling legislation, the *Marketing of Primary Products Act 1958*, the Tobacco Leaf Marketing Board is responsible for the marketing and selling of all Victorian tobacco leaf to Australian tobacco manufacturers.

3.1.93 Currently, there are 212 tobacco quota holders (growers subject to a production ceiling issued by the Board) located around Myrtleford in the north-eastern region of Victoria who produced 4.6 million kilograms of tobacco leaf for sale in 1993 (5 million kilograms, 1992). This level of production represents about 37 per cent of the total Australian tobacco crop.

3.1.94 The demand for Australian tobacco has declined dramatically as a result of progressive increases in the retail cost of tobacco products due to higher Federal excise duties and State licence fees. Demand for tobacco products has also been influenced by an increasing community awareness on health matters associated with such products. In this context, the national quota for tobacco leaf set by the Australian Tobacco Marketing Advisory Committee has been reduced from 12.6 million kilograms for 1993 to 8.2 million kilograms for 1994. On this basis, Victoria's share of the national quota will equate to around 3 million kilograms for the current year, **representing a decrease of 35 per cent in the State's tobacco production.**

3.1.95 Based on Victoria's share of the national quota and an average minimum selling price of \$6 per kilogram established by the Advisory Committee, audit estimates that the aggregate sales value of Victorian tobacco for 1994 will be around \$18 million, down \$10 million from the previous year.

3.1.96 In December 1993, the Government announced its intention to provide a financial assistance package of \$3 million to the State's tobacco industry, under which offers to buy back tobacco quotas would be made to growers who wish to voluntarily leave the industry. Under the terms of the financial assistance package, growers have until the end of May 1994 to apply to participate in the buy-back scheme. The Department of Agriculture anticipates that the provision of funding to growers who opt to retire from the industry will be finalised around August 1994.

PLANNED DEREGULATION OF INDUSTRY

3.1.97 The Government's announcement of December 1993 also indicated the intention to deregulate the State's tobacco industry. It stated that this move would put Victoria on a sound footing when the Federal Government's deregulation of the national tobacco industry occurs in September 1995.

3.1.98 A new co-operative, the Tobacco Co-Operative of Victoria Ltd, has already been formed to act on behalf of growers. The Department has advised audit that legislation to provide for deregulation of the industry is likely to be presented to the Parliament during the current Autumn session. **The Department anticipates that deregulation, incorporating transfer of the Board's assets to the newly-formed co-operative, will occur around September 1994.**

VICTORIAN EGG MARKETING BOARD

DEREGULATION OF THE EGG INDUSTRY

3.1.99 In February 1993, the Government issued a discussion paper entitled *Proposals for Deregulating the Victorian Egg Industry* for industry feedback by early March 1993. The paper recognised that the State's egg industry had been under considerable market pressure following deregulation of egg industries in New South Wales and South Australia in 1989 and 1992, respectively. The paper also recognised that Queensland was moving to deregulate and Victoria would be the sole substantial egg-producing State with a regulated industry.

3.1.100 The Government's proposals included the transfer of assets and liabilities of the Victorian Egg Marketing Board to a producer co-operative (to be formed to serve the interests of producers in the deregulation process) and a declaration that compensation payments for the loss of hen quotas would not be part of the deregulation arrangements.

3.1.101 The Egg Industry Co-operative Ltd was subsequently established as the key producer body in the deregulation of the industry.

3.1.102 Following the discussion period, the Government announced, late in March 1993, its intention to deregulate the industry by 1 July 1993. Enabling legislation, the *Egg Industry (Deregulation) Act 1993*, was passed by the Parliament and made provision from 12 June 1993 for:

- all property and rights of the Board to be vested in the Co-operative at no cost;
- all liabilities of the Board to be liabilities of the Co-operative;
- the Co-operative to become the successor-in-law of the Board; and
- the dissolution of the Board.

3.1.103 The Victorian egg industry, per medium of the Co-operative, assumed full responsibility for its commercial future from that date.

Products division

3.1.104 The Auditor-General's *Report on Ministerial Portfolios, May 1993*, included comment on the poor early performance of the Board's products division which was responsible for the manufacture of surplus eggs into pulp and powder products. The division had incurred losses totalling \$813 000 for the 2 financial years ended 30 June 1992. This poor performance led to the issue of a qualified audit opinion on the 1991-92 financial statements of the Board on the basis of uncertainty surrounding the future viability of the division and the adequacy of the carrying value of related assets.

3.1.105 The Report also drew attention to actions which had been initiated by the Board to improve the long-term viability of the division. These actions were aimed at stabilising raw materials supply for egg products and servicing further markets for alternative meat or vegetable-based manufactured products. By 11 June 1993, the division was operating on a break-even basis in the face of considerable interstate and some overseas competition.

3.1.106 The plant and equipment of the division were reflected in the Board's final financial statements at a value of \$3.5 million based on a going concern valuation by the Valuer-General. This valuation clarified the previous uncertainty as to the carrying value of the assets of the division and removed the need to again qualify the Board's financial statements in respect of the division.

3.1.107 It is significant that the Government's deregulation discussion paper stressed the importance to the industry of the division achieving profitability in its own right.

Final operating results of the Board

3.1.108 In its final operating period, 1 July 1992 to 11 June 1993, the Board reported a net loss of \$2.9 million, compared with a loss of \$161 000 in 1991-92. This significant loss was mainly due to 2 extraordinary items, namely redundancy payments of \$2.2 million to 66 Board staff not engaged by the Co-operative, and the payment of \$567 000 to the Consolidated Fund in lieu of stamp duty which was not levied on the transfer of the Board's assets. In addition, the Board's result for the period was affected by a special employer contribution of \$630 000 to the Victorian Egg Marketing Board Superannuation Fund, based on actuarial advice, to bring the fund to a fully-funded position.

3.1.109 The Board's net equity (assets less liabilities) at 11 June 1993, which was transferred to the Co-operative at no cost in accordance with the enabling legislation, amounted to \$12 million. The most significant asset transferred was the Board's 4 hectare site (including buildings) at Keysborough which was valued at \$5 million.

**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

VICTORIAN EGG MARKETING BOARD

<i>Ministerial Portfolios, May 1993, pp. 29-31.</i>	Following over 2 years of operating losses by the products division, measures taken to improve its performance are steadily taking effect.	By 11 June 1993, the date of dissolution of the Board, the products division was operating on a break even basis in the face of considerable interstate and some overseas competition. For further comments, refer to paragraphs 3.10.104 to 3.10.107 of this Report.
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**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
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COMPLETED AUDITS

AGRICULTURE

Department of Agriculture	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	28 Sept. 1993	30 Sept. 1993
Daratech Pty Ltd	30 June 1993	No reporting requirements. Audit conducted at request of Treasurer.	25 Nov. 1993	7 Dec. 1993 (a)
Egg Industry Licensing Committee (b)	Period 1 July 1992 to 11 June 1993	30 Sept. <i>Egg Industry Act 1989, s.48.</i>	4 Aug. 1993	19 Aug. 1993
Grain Elevators Board	30 Sept. 1993	31 Dec. <i>Annual Reporting Act 1983, s.9.</i>	16 Dec. 1993	16 Dec. 1993
Melbourne Wholesale Fruit and Vegetable Market Trust (c)	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	25 Aug. 1993	30 Sept. 1993
Murray Valley Citrus Marketing Board	30 June 1993	31 Oct. <i>Murray Valley Citrus Marketing Act 1989, s.49.</i>	14 Sept. 1993	30 Sept. 1993
Northern Victorian Fresh Tomato Industry Development Committee	30 June 1993	30 Sept. <i>Agricultural Industry Development Act 1990, s.49.</i>	17 Sept. 1993	30 Sept. 1993
Tobacco Leaf Marketing Board	31 Mar. 1993	30 June. <i>Annual Reporting Act 1983, s.9.</i>	21 June 1993	22 June 1993
Victorian Dairy Industry Authority	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	16 Sept. 1993	30 Sept. 1993
Victorian Dried Fruits Board	31 Dec. 1992	31 Mar. <i>Annual Reporting Act 1983, s.9.</i>	26 Feb. 1993	26 Mar. 1993
"	"	"	22 Mar. 1994	31 Mar. 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - <i>continued</i>				
Victorian Egg Marketing Board (d)	Period 1 July 1992 to 11 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	14 Sept. 1993	14 Sept. 1993
Victorian Strawberry Industry Development Committee	Period 28 July 1992 to 30 June 1993	30 Sept. <i>Agricultural Industry Development Act 1990, s.49.</i>	23 Sept. 1993	30 Sept. 1993

(a) Qualified audit report issued.

(b) The Committee was dissolved with effect from 12 June 1993 under the *Egg Industry (Deregulation) Act 1993*.

(c) The Trust was replaced by the Melbourne Market Authority with effect from 21 December 1993 under the *Melbourne Wholesale Fruit and Vegetable Market Trust (Amendment) Act 1993*.

(d) The Board was dissolved with effect from 12 June 1993 under the *Egg Industry (Deregulation) Act 1993*.

Part 3.2

Arts, Sport and Tourism

KEY FINDINGS

VICTORIAN ARTS CENTRE TRUST

- Through finalisation of its inaugural corporate plan, the Trust has made positive progress in the development of a strategic management framework designed to enhance its role as a major arts organisation.
Paras 3.2.17 to 3.2.22
- The Trust needs to ensure that its business plan, currently under development, adequately addresses emerging opportunities within the performing arts industry and facilitates qualitative assessments of the Trust's contribution to cultural and arts development.
Paras 3.2.23 to 3.2.25
- A long standing policy of non-allocation of significant levels of indirect overhead expenses (almost \$10 million in 1992-93) to individual operating units has impeded decision-making and led to incomplete transparency of accountability to the Parliament.
Paras 3.2.39 to 3.2.46
- Relative to other major Australian performing arts centres, the Trust generates the highest level of aggregate revenue from its internally-funded operations.
Paras 3.2.47 to 3.2.48
- An important recent sponsorship initiative, *Arts Angels*, has the very desirable aim of assisting the wider community to benefit from the Art Centre's facilities, through the availability of more free and subsidised activities.
Paras 3.2.49 to 3.2.54
- Several important initiatives are under way within the Trust which are designed to enhance management processes and strengthen financial performance in commercial operations.
Paras 3.2.58 to 3.2.86
- There is a need for clearer reporting by the Trust to the Parliament on its performance in the discharge of its important community service obligations.
Paras 3.2.104 to 3.2.110
- Following the discovery of a fourth cracked node in the Centre's spire, the Trust determined to reconstruct the spire at an estimated overall cost of \$4.4 million.
Paras 3.2.111 to 3.2.115

KEY FINDINGS - *continued*

VICTORIAN GAMING COMMISSION

- For 1992-93, the gaming industry's first year of operations, the 2 gaming operators generated aggregate turnover of \$2.7 billion, with over \$2.4 billion returned to patrons.
Paras 3.2.120.3.2.125
- The growth of the gaming industry has continued during 1993-94 with aggregate turnover of \$4.7 billion generated to 12 March 1994 and turnover for the year likely to be in excess of \$6 billion.
Paras 3.2.126 to 3.2.131
- Notwithstanding the significance accorded by the gaming legislation to research relating to the social impact of gambling, only \$13 000 out of a total available amount of \$6.7 million, was applied from the Community Support Fund for this purpose during 1992-93.
Paras 3.2.135 to 3.2.138
- At the date of preparation of this Report, the total amount of \$7.8 million approved as the initial distribution from the Community Support Fund for 1993-94 had not been drawn from the Fund.
Paras 3.2.139 to 3.2.141
- The Government needs to ensure that periodic allocations from the Community Support Fund are adequately co-ordinated and that resultant outcomes, measured against appropriate benchmarks, are regularly reported to the Parliament and the community.
Paras 3.2.142 to 3.2.144

TOTALIZATOR AGENCY BOARD

- Significant changes in management strategies at the TAB resulted in the inclusion within its 1992-93 financial statements of abnormal expense adjustments totalling \$96 million.
Paras 3.2.149 to 3.2.178
- The TAB's audited 1993-94 financial statements will be particularly significant as an early source of independent information on the relative success of the TAB's new strategic direction.
Para. 3.2.179

3.2.1 Four Ministers, namely the Minister for Arts, the Minister for Gaming, the Minister for Sport, Recreation and Racing and the Minister for Tourism, have responsibility for operations within the Arts, Sport and Tourism sector. These Ministers have collective responsibility for the Department of Arts, Sport and Tourism.

3.2.2 Details of the specific ministerial responsibilities for public bodies within the Arts, Sport and Tourism sector are listed in Table 3.2A.

TABLE 3.2A
MINISTERIAL RESPONSIBILITIES WITHIN THE ARTS, SPORT AND TOURISM SECTOR

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Arts	Council of the Museum of Victoria Council of the State Library of Victoria Council of Trustees of the National Gallery of Victoria Film Victoria Geelong Performing Arts Centre Trust State Film Centre of Victoria Council Victorian Arts Centre Trust
Gaming	TAB Gaming Business Segment Tattersall Gaming Machine Division Victorian Casino Control Authority Victorian Gaming Commission
Sport, Recreation and Racing	Greyhound Racing Control Board Harness Racing Board National Tennis Centre Trust Totalizator Agency Board Victorian Institute of Sport Ltd Victorian Institute of Sport Trust
Tourism	Emerald Tourist Railway Board Swan Hill Pioneer Settlement Authority Tourism Victoria

3.2.3 Comment on matters of significance arising from the audit of certain of the above entities is provided below.

VICTORIAN ARTS CENTRE TRUST

REVIEW OF TRUST OPERATIONS

Background

3.2.4 The Victorian Arts Centre Trust was established in 1980 under the provisions of the *Victorian Arts Centre Act 1979* and is subject to the general direction and control of the Minister for the Arts. Under the legislation, the Trust is responsible for the strategic direction and management of the Victorian Arts Centre.

3.2.5 The Trust is comprised of 9 members, 5 of whom represent the interests of the public generally, 2 are National Gallery trustees, one is actively associated with promotion of the arts outside the metropolitan area and one is nominated by the Council of the Victorian College of the Arts.

3.2.6 The statutory objectives of the Trust are to promote, develop and present the arts at the highest standard and to encourage maximum use of the facilities and resources of the Victorian Arts Centre to ensure the cultural enrichment, entertainment and broadening of knowledge of the Victorian community.

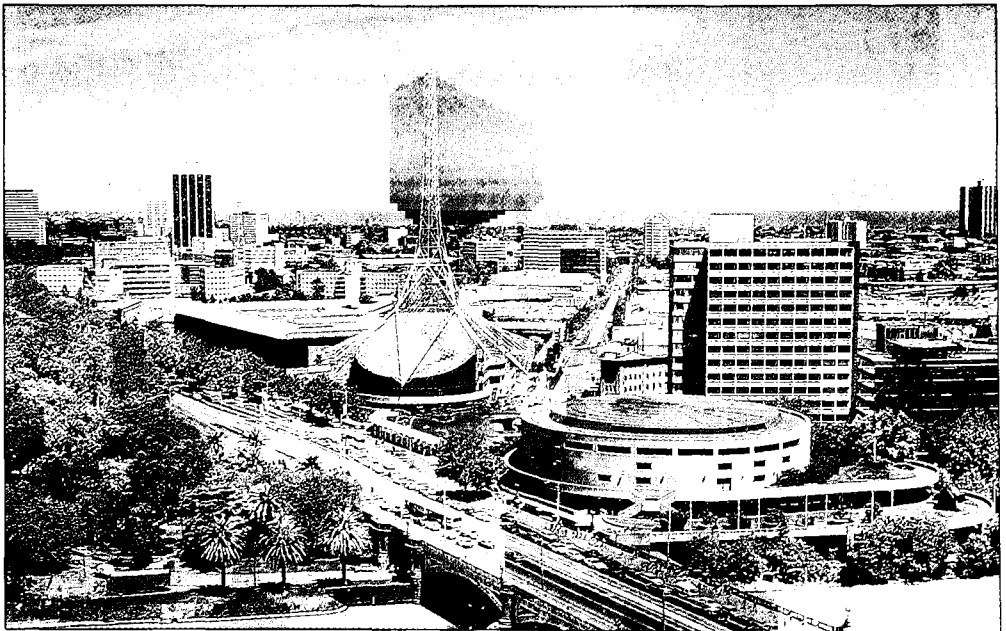
3.2.7 The Centre consists of 5 performing arts venues, namely the State Theatre, the Playhouse, the George Fairfax Studio (these 3 venues collectively constitute the Theatres' building of the Centre), the Melbourne Concert Hall and the Sidney Myer Music Bowl. The Centre does not include the National Gallery building located adjacent to it. The building is owned by the Trust and leased at no cost to the Council of Trustees of the National Gallery which, under separate legislation, is responsible for the building's management.

3.2.8 The performing arts venues within the Centre are rented by the Trust for the majority of each year to several principal performing arts organisations including The Australian Opera, The Australian Ballet, the Victoria State Opera, the Melbourne Symphony, and the Melbourne Theatre Company and to private hirers. For the remainder of the year, the Trust utilises the venues for the purpose of providing a diversity of educational, cultural and popular entertainment programs for the community.

3.2.9 The Trust is also responsible for management of the State Orchestra of Victoria and a number of commercial operations including the computerised ticketing service known as BASS, the Centre's car park and its catering facilities.

3.2.10 The Trust incurred an operating deficit of \$956 000 for 1992-93, after depreciation charges (other than for buildings) and provision for employee entitlements, compared with a deficit of \$900 000 for 1991-92. The Trust's revenue and expenses for 1992-93 totalled \$43 million and \$44 million respectively, with the principal sources of revenue for the year derived from business (commercial) operations (\$20 million), government funding (\$9.5 million) and income from the hiring of venues (\$9 million).

3.2.11 During 1993, audit carried out a review of the Trust's operations to determine whether it was meeting its statutory responsibilities and doing so in an economic, efficient and effective manner.



Victorian Arts Centre complex.

OVERALL CONCLUSION

3.2.12 The Victorian Arts Centre Trust has a dynamic and vital role in the promotion of arts and cultural entertainment within the State. This role involves the complex interaction of 3 principal responsibilities, namely a major cultural promoter, a significant property manager and a business manager involved in substantial commercial operations. Important community service obligations further widen the ambit of the responsibility base of the Trust.

3.2.13 From a strategic management viewpoint, the Trust is moving in a positive manner to address its responsibilities with a recently-developed inaugural corporate plan acting as the principal driving force. Its immediate challenge is to finalise its business plan and ensure that the plan adequately addresses all emerging opportunities within the performing arts industry and facilitates meaningful assessment of the quality of the Trust's contribution to cultural and arts development within the State. Strategies designed to exploit the Art Centre's competitive strengths in responding to the rapidly-growing Southbank precinct of Melbourne will need to be a key feature of the business plan.

3.2.14 A fundamental shortcoming in financial management procedures within the Trust over the years has been the non-allocation of significant levels of indirect overhead expenses to individual operating units. This practice has impeded internal monitoring and decision-making through the absence of information on the true financial performance of individual operations. It has also resulted in incomplete discharge by the Trust of its accountability obligations to the Parliament and the community. While some remedial action has recently been taken with regard to BASS, as a consequence of the Government's current review process in that area, the Trust should quickly move to initiate corrective action on the issue across the whole ambit of its operations.

3.2.15 Several important initiatives are under way within the Trust which are designed to enhance management processes and strengthen financial performance in key areas. These initiatives have been supplemented, in recent times, by an important sponsorship project, *Arts Angels*, which has the very desirable aim of assisting the wider community to benefit from the facilities and services of the Centre.

3.2.16 The Trust is well placed to make further inroads as a major cultural and arts organisation in its pursuit to be the Australian leader in its field.

Strategic management framework

Development of inaugural corporate plan

3.2.17 Although the Trust was established in 1980, it was not until 1990 that it commenced preliminary work on development of a corporate plan. This process culminated in the adoption of an inaugural corporate plan in November 1993 covering the 3 year period 1993-94 to 1995-96.

3.2.18 The Trust's **vision statement**, as embodied in the corporate plan, reads as follows:

"To be the Australian leader in the provision of quality entertainment experiences and related services to the broader community".

- 3.2.19** The vision statement is underpinned by the following 4 major strategic goals:
- to develop comprehensive balanced programs which express the cultural values of the broader community;
 - to have a highly motivated and well managed work force;
 - to sustain financial viability to ensure growth; and
 - to have appropriate, well managed physical resources.

3.2.20 Late in 1993, and in line with the goals documented within the corporate plan, the Trust implemented a new management structure which is designed to rationalise its key functions and to better delegate day-to-day management responsibilities, thereby enabling senior management to more effectively focus on strategic issues. The Trust's previous structure had remained unchanged for many years.

3.2.21 The new structure provides for 3 main operating areas: business (commercial operations), theatre operations (venue hire, programming) and corporate resources (support services). The Trust expects that implementation of the new structure will lead to significant financial savings in operating costs through the overall reduction of staff numbers and rationalisation of activities.

3.2.22 The Trust has developed action plans which are designed to ensure achievement of its strategic goals. Some of the more significant initiatives recently taken by the Trust under these plans include:

- introduction of revenue enhancement initiatives within catering and car park operations to improve the financial performance of these activities;
- review of existing information system plans and budgetary processes to ensure a more effective basis for decisions on resource allocation;
- continuation of negotiations with unions and staff to achieve workplace reforms and support a more efficient arts entertainment industry;
- development of venue hiring and car park systems to enable the provision of enhanced information flows for decision making purposes; and
- formation of a special arts sponsorship group, called *Arts Angels*, to provide for additional private sector funding of \$4 million a year to augment the Trust's financial standing.

3.2.23 The Trust is currently devoting considerable effort to the preparation of a 3 year *business plan* to link proposed management actions with the strategic goals embodied in the corporate plan.

3.2.24 The Trust has a dynamic and vital role to play in promotion of arts and cultural entertainment in the State. In this context, it will be important that the business plan adequately addresses the highly complex interaction of the Trust's principal responsibilities, namely a high-level **cultural promoter** of performing arts, a **property manager** of a substantial purpose-built complex costing in excess of \$300 million and a **business manager** with substantial commercial operations generating some \$20 million annually in gross earnings. These responsibilities should be addressed within the business plan against a background of increasing community expectations in terms of services and programs offered free or at subsidised levels by the Trust under its **community service obligations**.

3.2.25 The business plan will also need to encompass strategies aimed at exploiting the Trust's competitive strengths in order to meet the emerging challenges and threats associated with the rapidly-growing Southbank precinct of Melbourne, which includes the Centre. These challenges and threats principally involve opportunities for the Trust to:

- attract more patronage to the Centre from its strategic location in the precinct;
- enhance the competitiveness of its catering facilities to better accommodate services demanded by visitors to the precinct;
- expand the market position of its car parking operation in response to increasing competitive pressures in the area; and
- capitalise on emerging business and marketing opportunities arising from the State's casino, including a major hotel complex, currently under construction in the precinct.

3.2.26 At the time of the audit review, the Trust was in the process of preparing a *master plan* covering future capital developments at the Centre together with related funding considerations. As part of this process and, in consultation with an architect, the Trust is considering various options to improve the design and functionality of the Centre.

3.2.27 **The Trust has made early progress in the development of a strategic management framework which is aimed at enhancing its role as a major provider of arts and cultural entertainment. The ultimate effectiveness of this framework will be significantly influenced by the extent to which important emerging developments, mainly relating to the Southbank precinct, are adequately addressed in the Trust's *business plan*.**

Performance monitoring and reporting

3.2.28 For any major organisation, such as the Trust, which seeks to operate effectively within an increasingly competitive environment, it is important that mechanisms are in place to enable the organisation to evaluate, in a meaningful way, the extent and quality of progress achieved in the attainment of corporate goals.

3.2.29 With the absence, in previous years, of a corporate plan to provide an overall strategic direction, internal performance monitoring mechanisms of the Trust have focused predominantly on the annual budgetary process and, in particular, on the matching of annual revenue and expenditure against related financial targets. While this approach may have been appropriate to meet the needs of the Trust in the early years of its operations, it is inherently deficient in that it is quantitative in nature and focuses principally on cost inputs. **As such, this past practice has limited usefulness in terms of contemporary demands now placed on the Trust for ensuring systematic measurement of its performance in the achievement of high-level arts and cultural goals and related outcomes.**

3.2.30 To satisfy its external accountability obligations to the Parliament and the wider community on its progressive performance as a major arts organisation, the Trust has, since 1988-89, presented within its annual report a statistical supplement showing information on attendances and average capacity relative to available capacity for performances. Table 3.2B summarises this information.

**TABLE 3.2B
ATTENDANCES AND AVERAGE CAPACITIES AT VENUES OF THE CENTRE**

Venue		1988-89	1989-90	1990-91	1991-92	1992-93
Melbourne Concert Hall						
Attendances	('000)	470	481	445	467	463
Average capacity	(%)	83	79	75	72	73
State Theatre						
Attendances	('000)	459	422	477	494	465
Average capacity	(%)	81	79	86	86	80
Playhouse						
Attendances	('000)	255	207	197	186	228
Average capacity	(%)	83	71	69	62	76
George Fairfax Studio						
Attendances	('000)	33	45	42	39	39
Average Capacity	(%)	44	65	65	60	60
Sidney Myer Music Bowl (a)						
Attendances	('000)	190	184	183	197	156
Other attendances	('000)	222	289	262	222	295
Total attendances	('000)	1 629	1 628	1 606	1 605	1 646

(a) Information on average capacity at the Sidney Myer Music Bowl was not compiled by the Trust.

3.2.31 While the statistical data published by the Trust has provided an indication of the relative success or otherwise of performances at the Centre's main venues, it provides no information on the extent of usage of all facilities at the Centre. Also, similar to the position with the Trust's internal monitoring mechanisms, the statistical information reported to the Parliament has been of a quantitative nature without disclosure of qualitative assessments of performances held at the Centre.

3.2.32 Since its 1991-92 Annual Report to the Parliament, the Trust has extended its statistical data to provide information on its achievements against a number of performance indicators. Table 3.2C outlines the performance indicators presented in the 1992-93 Annual Report.

**TABLE 3.2C
PERFORMANCE INDICATORS**

Performance Indicator		1988-89	1989-90	1990-91	1991-92	1992-93
Self-funded operational expenditure	(\$million)	27.1	31.3	32.5	34.4	33.0
Government Recurrent funding as % of total expenditure		17.2	14.1	13.4	12.5	12.3
Contribution from business activities	(\$million)	2.7	3.6	3.6	4.4	3.3
BASS ticket sales	(million)	3.2	3.5	4.0	4.2	3.9
Number of performances in major venues		1 103	1 141	1 090	1 040	1 089
Aggregate number of people using the Centre	('000)	1 629	1 628	1 606	1 605	1 646
Number of children at Victorian Arts Centre ART-ED performances	('000)	48.4	76.2	82.5	76.7	74.8
Number of free performances		510	570	500	359	341
Recurrent funding per attendance	(\$)	3.41	3.10	3.11	3.09	2.90

3.2.33 Because the above information represents a consolidation of a variety of performance data without elaboration on the relative significance of individual indicators or their relationship with other indicators, audit found it difficult to form meaningful conclusions from the table on the overall performance of the Trust.

3.2.34 The main impression that can be gained from the information is that the level of government recurrent funding has fallen over the last 5 years, which is reflected in the decline in subsidised ART-ED and free performances and that, over the period, the Trust has expanded its self-funded activities. The table also shows that the number of performances at the Centre and the number of patrons attending those performances have been fairly stable.

3.2.35 The Trust recognises the need for improving its past approach to performance measurement and reporting, and for formulating, as part of its corporate planning process, qualitative measures which can be linked to its outcomes as a major arts and cultural organisation. As an important initiative, the Trust is currently in the process of arranging a consultancy review of its operations by a recognised international arts and business specialist. Audit was advised that a major element of this consultancy will be the development of appropriate performance benchmarks for the Trust.

3.2.36 In discussions with the Trust, audit emphasised the importance of linking its performance measurement framework with its key roles as a business manager, property manager and cultural promoter.

3.2.37 For example, because of the increasing significance and complexity of its business operations, the setting of financial performance benchmarks should be based on aggregate costs and reflect competitive realities of the marketplace. In terms of its property management responsibilities, mechanisms need to be in place for the periodic reporting of the extent of utilisation of the total facilities of the Centre. Finally, in relation to its role as a cultural promoter, the emphasis in performance should focus on qualitative factors which will enable an assessment of the Trust's contribution to maintaining the State's reputation as the performing arts capital of the nation, particularly from the viewpoint of both hirers and the public.

3.2.38 **The Trust is in the early stages of substantially upgrading the effectiveness of its performance measurement and reporting processes to complement its strategic management framework.**

□ RESPONSE provided by General Manager, Victorian Arts Centre Trust

It is not accurate to state that the Trust has not addressed qualitative issues in relation to performance monitoring. Qualitative requirements have significantly influenced the Trust's decision-making in the areas of VACT programming and entrepreneurial activities. However, it is true that qualitative factors have not been publicly reported to the same extent as quantitative factors, due to the inherent difficulty in measuring qualitative outcomes and the risks associated with their misinterpretation.

In addition, as the hirer-out of venues, the Trust does not control the performances mounted by hirers. It would be inappropriate for the Trust to undertake and disclose the results of qualitative assessments of performances over which it has no control.

With respect to the extent of usage of facilities at the Centre, the VACT collects and distributes internally weekly and monthly statistics.

With respect to the slight decline in ART-ED attendances during 1991-92 and 1992-93, another important reason for this was the effect on schools of several restructures within the Victorian Directorate of School Education.

Attention is being given currently to improving the VACT's management information systems and reporting practices.

Financial operations

3.2.39 With levels of annual revenue and expenditure now in excess of \$43 million, the Centre is clearly a highly significant enterprise from a financial management viewpoint. Table 3.2D summarises the financial operations of the Centre over the 5 year period to 30 June 1993.

TABLE 3.2D
5 YEAR COMPARATIVE REVENUE AND EXPENSE STATEMENTS
('\$000)

Item	1988-89	1989-90	1990-91	1991-92	1992-93
Revenue -					
Commercial operations	16 956	18 795	19 716	20 655	20 135
Government grants -					
Recurrent	5 266	5 105	4 998	4 898	4 774
Works & services	685	1 065	1 347	1 293	1 181
State Orchestra of Victoria	2 891	2 943	3 107	3 217	3 886
Hire of venues	6 845	7 488	7 904	8 044	9 005
Programming activities	1 765	2 425	1 466	2 270	1 324
Donations	810	1 318	961	1 660	1 068
Other	394	601	1 228	1 766	1 751
Total revenue	35 612	39 740	40 727	43 803	43 124
Expenses -					
Commercial operations	14 199	15 218	16 133	16 309	16 958
Hire of venues	7 225	7 891	8 302	8 778	8 761
Programming activities	2 933	3 593	2 904	4 075	3 040
State Orchestra of Victoria	2 788	2 806	3 378	3 551	3 526
Depreciation and employee entitlements	1 936	1 454	1 497	1 664	1 106
Other	609	858	674	949	782
Unallocated expenses -					
Support services	6 528	6 979	7 369	8 086	8 621
Works and services	684	1 065	1 345	1 289	1 286
Total expenses	36 902	39 864	41 602	44 701	44 080
Operating (deficit)	(1 290)	(124)	(875)	(898)	(956)

3.2.40 The table shows that the Trust has generated higher levels of revenue from its commercial operations over the past 5 years. The Trust deserves to be commended for this achievement, particularly as it occurred during a period of depressed economic activity within the State, and the arts and entertainment industry is directly affected during difficult economic periods.

3.2.41 Also, this progress was achieved during a period in which the Trust did not have a structured framework in place for articulating its strategic direction, which meant that its decision-making was directed towards maximising financial outcomes of its individual activities rather than on an organisational basis derived from a corporate plan.

Non-allocation of major levels of expenses

3.2.42 Table 3.2D discloses that a significant level of the Trust's annual expenses, described as support services and works and services, is not allocated to individual operations. Unallocated expenses for 1992-93 totalled almost \$10 million.

3.2.43 This situation reflects a long-standing practice by the Trust under which indirect administrative and maintenance overheads such as staffing costs, promotion activities, minor works and cleaning, are not allocated to its major operating units. The practice in this area is consistent with that followed by other major performing arts centres across Australia.

3.2.44 In discussions with the Trust, audit was advised that the principal reason for non-allocation of indirect overheads was to protect the commercial confidentiality of its business operations. The major disadvantages of the Trust's policy in this area are:

- it is not in a position to identify the true financial performance i.e. the "bottom line" net profit or loss of its various activities, and therefore, to reach optimum decisions on resource management matters; and
- there is incomplete discharge of its accountability obligations to the Parliament and the community in terms of full reporting on the financial performance of its commercial and other operations.

3.2.45 Audit expressed the view to the Trust that these factors outweighed matters associated with commercial confidentiality. In fact, **the Trust's policy on non-allocation of indirect overheads represents a fundamental shortcoming in its financial management procedures and falls far short of the standard expected of major public sector organisations in today's environment.** Audit has encouraged the Trust to become a leader in financial reporting within the performing arts industry by external disclosure, on an annual basis, of the true financial performance of its individual operations.

3.2.46 **The Trust should move to ensure that all costs are allocated to key areas of operation so that there is a sound basis for decision-making and complete transparency of accountability to the Parliament for its financial performance.**

□ RESPONSE provided by General Manager, Victorian Arts Centre Trust

In the past, the Trust has considered but not proceeded with the allocation of indirect overheads for 3 main reasons:

- (1) commercial confidentiality;*
- (2) the lack of demonstrable benefits to be gained by doing so; and*
- (3) the difficulties caused by the Arts Centre having a significant number of areas (e.g. foyers and general public spaces) and functions (e.g. negotiations with Government, national and international liaison) which cannot be allocated to its operating units.*

With respect to point (2) above, the Trust believes that the main benefits of support service allocation is to determine hiring-out charges which should attempt to cover all costs. In practice, however, hiring-out charges are driven more by government regulations on fees and charges and the hirers' ability to pay, rather than on a cost plus or minus basis. Nevertheless, at the time of writing, the VACT was in the process of developing a quarterly report which allocates support service costs to operating units, insofar as possible, as a supplementary financial report for the consideration of the Trust. In conclusion, the Trust believes that the allocation of indirect overheads is an arbitrary and subjective exercise that adds little to better inform management decision-making.

Extent of reliance on government recurrent funding

3.2.47 During the review, audit compiled information on the level of government recurrent funding provided to the Trust compared with the equivalent funding position of other significant performing arts centres across Australia. Table 3.2E provides relevant details for the year ended 30 June 1993.

TABLE 3.2E
LEVEL OF GOVERNMENT RECURRENT FUNDING PROVIDED TO PERFORMING ARTS CENTRES WITHIN AUSTRALIA FOR YEAR ENDED 30 JUNE 1993

<i>Performing arts centre</i>	<i>Government recurrent funding</i>	<i>Centre-generated funds</i>	<i>Total revenue</i>	<i>Centre funds percentage of total revenue</i>
	<i>(\$m)</i>	<i>(\$m)</i>	<i>(\$m)</i>	<i>(%)</i>
Victorian Arts Centre Trust Concert Hall, State Theatre, Playhouse, George Fairfax Studio, Sidney Myer Music Bowl	4.8	33.3	38.1	87.4
Sydney Opera House Trust Concert Hall, Opera Theatre, Drama Theatre, Playhouse, Reception Hall	13.0	26.4	39.4	67.0
Adelaide Festival Centre Trust Festival Theatre, Playhouse, The Space, Her Majesty's Theatre	3.3	21.6	24.9	86.7
Queensland Performing Arts Trust Concert Hall, Cremorne Theatre, Lyric Theatre	2.9	9.6	12.5	76.8

3.2.48 The above table indicates that, relative to the other major Australian performing arts centres, the Victorian Arts Centre Trust generates the highest level of aggregate revenue from its internally-funded operations.

Recent initiative on external sponsorship

3.2.49 Although a relatively small percentage of annual revenue, external donations are an important source of funding for the Trust to assist it in the provision of quality services to clients and patrons. In 1992-93, donations totalled \$1 million compared with \$1.7 million in the previous year. At 30 June 1993, the Trust held unexpended donations of \$2.2 million.

3.2.50 The audit review found that management of donations is strictly controlled by the Trust with detailed records maintained to record donated amounts and the specific requirements of sponsors. The Trust carefully manages donations to ensure the application of funds is in line with specific intentions or conditions specified by sponsors.

3.2.51 The Chairman of the Trust recently announced details of a new fundraising initiative titled the *Arts Angels* which is aimed at supplementing donation income to enable the Trust to extend its services to a broader cross-section of the community, through more free and subsidised activities. The formation of this new form of patronage support has been in response to an identified need to attract new audiences and make wider use of the Centre's facilities.

3.2.52 The Trust has targeted an amount of \$4 million to be raised annually under the initiative. By late March 1994, the Trust had obtained commitments of \$2 million comprising \$1 million in initial seed funding from its Chairman (of which an amount of \$700 000 has already been received), and \$1 million from 10 individuals or organisations, each donating \$100 000. The Trust expects the remaining \$2 million to be committed by a further 20 sponsors.

3.2.53 It is understood that funds provided under the *Arts Angels* initiative will have no specified conditions attached to their application, which will provide substantial flexibility to the Trust.

3.2.54 **The establishment by the Trust of *Arts Angels* as a fundraising activity is a proactive initiative. The Trust has the important responsibility of ensuring that sponsorship funds are used to maximum benefit with meaningful reporting to both sponsors and the Parliament on outcomes.**

Commercial operations

3.2.55 The commercial operations of the Trust are its major source of revenue. In 1992-93, these operations generated revenue of \$20 million and related mainly to BASS (\$8.3 million), the Centre's catering facilities (\$7.9 million) and its car park (\$2.7 million).

3.2.56 As outlined earlier in this Report, the non-allocation by the Trust of significant levels of indirect overhead expenses to commercial and other operations precludes determination of the true financial performance of those operations. Nevertheless, it is clear that the gradual increase over recent years in revenue derived from commercial activities has eased the impact on the Trust of declining levels of recurrent funding from government. It is also clear that commercial operations will become increasingly significant to the Trust as it proceeds through its current corporate planning period and beyond to the next century.

3.2.57 Comments on the performance of the Trust's 3 main commercial operations and initiatives taken by the Trust to enhance their profitability follow.

BASS

3.2.58 BASS, an acronym for *Best Available Seating Service*, is the business trading name of a computerised ticketing service which operates as a trading division of the Trust. It was established in 1978 to:

- help make the Trust less dependent upon government funding;
- provide box office facilities for the Centre; and
- offer a computerised ticketing system to the entertainment industry with state-of-the-art technology for ticket selling.

3.2.59 The Trust holds a software licence agreement with Ticketmaster Corporation of the United States of America to operate in Victoria, Tasmania and the Australian Capital Territory.

3.2.60 Current major clients of BASS include the Melbourne Cricket Ground Trust, the National Tennis Centre Trust and the Olympic Park Committee of Management in respect of the Melbourne Sports and Entertainment Centre.

3.2.61 The services provided by BASS to clients include a computerised network for the sale of tickets through retail sales outlets and telephone booking facilities, and the retention and investment of funds on behalf of clients until performances or events have taken place. The capacity of BASS to provide to clients, under the Ticketmaster software, a real-time computerised seating system which can disclose seating availability for coming performances or events is a key element of its competitive strength.

3.2.62 The Trust's policy of non-allocation of all indirect expenses to commercial operations has meant that the only information available for analysis of the financial performance of BASS has been its **gross contribution, i.e. revenue commission less direct expenses** in each year. Table 3.2F summarises the gross contribution of BASS for the last 4 financial years.

TABLE 3.2F
SUMMARY OF GROSS CONTRIBUTION BY BASS FOR THE
PERIOD 1989-90 TO 1992-93
('\$'000)

<i>Item</i>	<i>1989-90</i>	<i>1990-91</i>	<i>1991-92</i>	<i>1992-93</i>
Revenue commission	5 728	7 132	8 995	8 288
Less				
Direct expenses	4 364	5 442	6 536	6 968
Gross contribution	1 364	1 690	2 459	1 320

3.2.63 The substantial increase in commission revenue generated by BASS in 1991-92 was primarily due to the introduction of a charge on retailers in January 1991 and ticket sales handled by the service for the highly successful musical production *Phantom of the Opera*, which commenced in December 1990 at the Princess Theatre in Melbourne. Revenue commission to BASS from this musical totalled \$1.6 million for the period from December 1990 to its closure in June 1993.

3.2.64 BASS experienced a decline in its gross contribution in 1992-93 as a result of a reduction in revenue derived from booking fees, higher costs associated with the preparation of BASS for sale or privatisation, and costs related to the opening of additional outlets.

3.2.65 With effect from 1 July 1993, the Trust determined to separately identify all of its operations associated with BASS, including indirect costs, to facilitate the Government's current review in the area. **Such action will mean that the true financial performance of BASS will be available, for the first time, from and inclusive of the 1993-94 financial year.** The Trust has budgeted for a net profit of \$1.3 million from the operations of BASS for 1993-94.

3.2.66 **Full reporting by the Trust of the financial operations of BASS is fundamental to proper discharge of its accountability obligations to the Parliament and the community.**

Government review of future direction of BASS

3.2.67 In its 1993-94 *Budget Paper No. 2*, the Government indicated that it had commenced a review of the options available, including privatisation, for the future direction of BASS. It stated that, as part of this process, it had consulted extensively with theatre and other venue operators, promoters, ticketing agencies and interested parties.

3.2.68 Since the Government's announcement, the review process, which has included the engagement of external consultants, has proceeded under the overview of the Office of State Owned Enterprises within the Department of the Treasury. **At the date of preparation of this Report, a final decision by the Government on the future of BASS had not been reached.**

□ RESPONSE *provided by General Manager, Victorian Arts Centre Trust*

Full direct and indirect cost accounting was introduced for BASS from 1 July 1993. Therefore, the Trust's accountability obligations with respect to BASS will be met.

Catering services

3.2.69 Because of its role as a major arts and entertainment organisation, the provision of catering services to patrons attending performances or to members of the public visiting or passing the Centre constitutes a significant part of the Trust's ongoing operations

3.2.70 The Trust's catering services encompass The Vic Restaurant (a large restaurant within the Centre), the Treble Clef Cafe (situated on the Southbank precinct), and lounges and food foyers at various locations within the Centre. The management of all major catering services at the Centre is contracted to a private sector catering organisation.

3.2.71 Under the contracting arrangements, the Trust receives all sales proceeds and incurs all costs associated with its catering operations. In addition to a management fee, it is required to pay to the contractor a productivity incentive allowance which is linked to an annual profit budget target agreed by the parties.

3.2.72 Table 3.2G summarises the gross contribution levels (i.e. exclusive of indirect overhead expenses) of the Trust's catering services for the 4 year period 1989-90 to 1992-93:

TABLE 3.2G
CATERING GROSS CONTRIBUTIONS FOR THE PERIOD
1989-90 TO 1992-93
('\$000)

<i>Item</i>	<i>1989-90</i>	<i>1990-91</i>	<i>1991-92</i>	<i>1992-93</i>
Revenue	10 790	10 094	9 184	7 914
Less cost of sales	3 653	3 335	3 043	2 593
Gross profit	7 137	6 759	6 141	5 321
Less direct costs	6 251	6 147	5 508	4 985
Gross contribution	886	612	633	336

3.2.73 The above table shows that catering revenue during 1992-93 amounted to \$7.9 million, a reduction of \$1.2 million from the previous year and that the gross contribution for the year declined by around 50 per cent, from \$0.6 million to \$0.3 million.

3.2.74 In discussions with audit, the Trust advised that the principal reason for the downturn in the financial performance of catering services during 1992-93 was increased competition from the recently-developed catering outlets within the Southbank precinct.

3.2.75 Actions recently taken by the Trust which have been aimed at achieving increased patronage at its various catering outlets have included:

- commissioning, in 1992, of an external consultancy review of all catering services;
- establishment of an outdoor eating area for the Treble Clef Cafe, which is specifically designed to attract the increasing number of visitors to the Southbank precinct; and
- setting of key benchmarks for its major catering outlets to upgrade the effectiveness of its periodic monitoring of catering performance.

3.2.76 The results of the consultancy review were reported to the Trust in September 1992. A principal finding of the consultant was that the design and location of the Centre's 2 kitchens, which are situated in separate buildings, were not conducive to efficiency of operations, particularly in relation to storage capabilities and labour costs involved in the transportation of meals.

3.2.77 The report recommended that consideration be given by the Trust to the concurrent re-design of the catering outlets and of kitchen and storage areas as key steps in the upgrading of catering services to meet patrons' needs in an increasingly competitive market. At the date of preparation of this Report, the consultant's recommendations were under consideration by the Trust as part of the development of its masterplan for the redesign of the Centre's facilities.

3.2.78 The recent competitive pressures from the Southbank precinct have adversely impacted on catering revenues at the Centre. These pressures will require early remedial action by the Trust following its review of catering services.

□ RESPONSE provided by General Manager, Victorian Arts Centre Trust

A second significant reason for the decline in income from catering in 1992-93 was a reduction of approximately 20 per cent in opera audiences, such patrons traditionally spending more per head than other patrons in the VACT restaurants and food outlets. Also, research indicated that those who did patronise the VACT's restaurants, food outlets and bars spent less per head in 1992-93 than in previous years.

The Trust has instituted a range of marketing initiatives during 1993-94 which have successfully capitalised on the increased flow of traffic in the precinct and resulted in increased patronage of the Centre's restaurants and food outlets. A significant increase in catering revenue is expected in 1993-94.

Car park

3.2.79 The Centre's car park has a capacity for 1 160 vehicles and provides a convenient facility for patrons attending the Centre and for workers within the central business district of Melbourne. The gross contribution of car park operations for 1992-93 amounted to \$1.6 million compared with \$1.2 million for 1991-92.

3.2.80 For some years, the Trust had leased its car park to an external party. In October 1992, two and a half years before termination of the lease, the Trust reached agreement with the lessee to buy back the lease in return for compensation of \$1.6 million, payable by monthly instalments of \$50 000. The basis for this decision was that higher gross contributions from the car park could be generated from arrangements which provided greater control to the Trust.

3.2.81 From August 1992, the lessee had engaged an external party to manage the carpark and this manager was retained by the Trust following the October 1992 termination of the lease.

3.2.82 In the period since October 1992, higher levels of gross contribution have been generated by the car park with an additional \$400 000 returned up to 30 June 1993 and \$300 000 up to the end of March 1994. This favourable revenue trend supports the earlier decision of the Trust to terminate the previous lease arrangements.

3.2.83 Similar to the position previously described with catering services, the Trust has recently implemented a number of measures aimed at improving the financial performance of its car park. These measures have included:

- monitoring of average hourly occupancy levels;
- adoption of an early bird parking scheme offering discount rates to patrons; and
- repainting of parking areas.

3.2.84 The Trust is currently considering a number of additional steps for the car park including provision of a prepay facility for regular patrons, construction of a pedestrian ramp to assist disabled patrons and specific marketing initiatives such as promotion of the carpark for corporate bookings.

3.2.85 The importance of the measures already taken and those under consideration by the Trust is reinforced by the presence within the Southbank precinct of a significant carparking competitor. The Trust has advised audit that it expects to implement the majority of its proposed actions within the near future.

3.2.86 The Trust has taken positive steps to increase the financial return from its car park and is in the process of further enhancing carparking facilities to attract additional patronage.

Hire of venues

3.2.87 For the majority of each year, the Trust rents the Centre's 5 performing arts venues to several principal performing arts organisations. Approximately 55 per cent of the Trust's annual hiring revenue is derived from these principal performing arts organisations.

Analysis of financial performance

3.2.88 Table 3.2H summarises the gross contribution to the Trust from the hiring of its venues for the 3 year period ended 30 June 1993:

TABLE 3.2H
GROSS CONTRIBUTIONS FROM THE HIRING OF VENUES,
1990-91 TO 1992-93
('\$000)

<i>Item</i>	<i>1990-91</i>	<i>1991-92</i>	<i>1992-93</i>
Revenue	7 904	8 043	9 005
Less direct expenses	8 301	8 778	8 761
Gross contributions	(397)	(735)	244

3.2.89 The audit analysis of hiring activities found that 2 factors, namely, the process of setting of annual hiring rates and depressed economic activity within the State, were the major reasons for the fluctuating results between 1990-91 and 1992-93.

3.2.90 In terms of the fee setting process, the Trust has been required since 1986, to obtain government approval for annual hiring rates. Approved rates have been traditionally applied on a calendar year basis in line with the structure of the State's annual arts season.

3.2.91 Up until 1986, the Trust had freedom to set hiring rates which were based on direct operating costs. For the period 1986 to 1990, rates were subject to Government approval with the level of annual increase during those years set by the Government at between 5 and 7 per cent. During this period, the level of hiring rates did not equate with movements in direct operating costs incurred by the Trust in the provision of hiring facilities, i.e. hiring revenue rates were set at a level which did not recover direct costs (without even considering indirect costs). This position led to negative gross contributions from hirings of \$526 000 and \$345 000 incurred by the Trust in 1988-89 and 1989-90 respectively.

3.2.92 For 1991 and 1992 rate increases sought by the Trust were approved by the Government for the 3 venues comprising the bulk of hiring activities, namely an increase of 12 per cent for the State Theatre and the Playhouse, and 9 per cent for the Melbourne Concert Hall. In normal circumstances, these increases should have resulted in improved gross contributions from hirings in 1990-91 and particularly in 1991-92, when the full year impact of the higher rates would have applied. However, negative gross contribution levels continued to be experienced in those years with a substantial deterioration in the result for 1991-92. Audit was advised by the Trust that these disappointing results were primarily due to the depressed economic conditions within the State at the time.

3.2.93 The approved increases for hiring rates for 1993 and 1994 were set by the Government at an overall level of 3 per cent which involved a steep decline from the 1991 and 1992 increases. Through containment of costs and increased hirings, the Trust was able to generate the positive gross contribution of \$244 000 in 1992-93, which was the first positive result for many years. The Trust expects to achieve a similar outcome in 1993-94.

3.2.94 There are 2 principal conclusions which can be drawn from the above historical analysis of the fee setting arrangements for hiring, namely:

- hiring rates have no direct relationship with associated hiring costs, and periodic gross contribution levels are significantly influenced by government decisions on annual hiring rates and prevailing economic conditions; and
- actions within the control of the Trust which can influence annual results for hiring are limited principally to strategies to increase the magnitude of hirings and to achieve productivity gains through minimisation of costs.

3.2.95 While decisions by government on annual hiring rates significantly influence hiring results, allocation by the Trust of all indirect costs is necessary before the true financial result for hiring can be determined. Information reported annually by the Trust to the Parliament on hirings should also disclose the extent of government subsidy in this area.

□ *RESPONSE provided by General Manager, Victorian Arts Centre Trust*

Hiring rates are determined on the basis of hiring costs, but then the rates are modified by government directive and market factors, in particular, the ability of hirers to pay. To set hiring rates at levels which will recoup all direct and indirect costs would put them beyond the means of hirers and, as a result, have a negative effect on the Arts Centre business.

Importance to the Trust of ongoing viability of major venue hirers

3.2.96 As indicated earlier in this Report, the major hirers of performing arts venues within the Centre include The Australian Opera, The Australian Ballet, the Victoria State Opera, the Melbourne Symphony and the Melbourne Theatre Company.

3.2.97 Although these principal performing arts organisations have consistently utilised venues at the Centre over the years, they do not enter into long-term agreements with the Trust. Hiring arrangements between the Trust and the individual organisations generally relate to particular performances or a segment of the annual arts season.

3.2.98 In discussions with the Trust, audit was advised that the principal reason for the absence of long-term hiring agreements was the dependence of the performing arts organisations on government and other external sources of funding, e.g. sponsorship, and that the extent of their future commitments would be influenced by their short-term assessments of available financial resources.

3.2.99 Given these circumstances, the Trust is not in a position to plan on a long-term basis, with absolute certainty, the extent of utilisation by major hirers at the Centre. In this regard, if a principal performing arts organisation experiences financial difficulty or its level of government funding were to be reduced or withdrawn, the Trust could experience a loss of hiring revenue or be faced with the need to financially assist the organisation.

3.2.100 An example of the latter circumstance occurred during 1993, when as a result of the financial difficulties experienced by the Victoria State Opera, the Government approved the following financial assistance package for the organisation:

- provision of a loan of \$2.4 million with repayments to commence in December 1994;
- maintenance of annual State government grants of \$1.1 million for the next 3 years;
- early release by the Trust of \$2.3 million in subscription moneys which would normally be retained by BASS until related performances are held; and
- deferral of rental payments of \$175 000 owing to the Trust for the use of the State Theatre.

3.2.101 The provision of the financial support package was conditional upon the Victoria State Opera achieving a significant reduction in its annual operating expenditure.

3.2.102 The Trust advised audit that early signs indicate some improvement in the Victoria State Opera's financial performance since provision of the special financial assistance.

3.2.103 While early release of subscription moneys to the Victoria State Opera created a temporary financial exposure to the Trust, the provision of special financial assistance should enable the organisation to continue to be a major hirer of the facilities at the Centre.

Community service obligations

3.2.104 The Trust discharges important community service obligations on behalf of the Government through special programs for the broader community. These programs are specifically aimed at enhancing public awareness of the performing arts and making available subsidised or free services to the community. The programs include:

- **Educational programs** (known as **ART-ED**) for schools, aimed at providing an opportunity for young people to become aware of and gain an understanding of the performing arts. The programs have 3 components, namely performances for schools at the Centre), *Country Access*, which brings students from rural Victoria to "country activity" days at the Centre, and *Winterarts* which involves the cultivation of a long-term relationship between the professional performing arts and schools; and
- **Community programs** which focus on encouraging the public to experience a broad range of performing arts activities at subsidised costs. Programs presented include *Morning Melodies* for elderly patrons, *Free Lunch Time Concerts*, *Lunch and Laugh* programs, *Open Mind*, and family and children programs.

3.2.105 While the number of ART-ED programs has declined from 198 to 162 over the past 4 years, attendances have remained fairly stable, with around 76 000 students attending the Centre in 1992-93. These programs are subsidised, however, the Trust advised audit that transport costs to the Centre, particularly for students from rural Victoria, impose an additional financial burden which impacts on the ability of students to attend.

3.2.106 With community programs, the number of performances and attendance levels have declined from 145 and 93 500 respectively in 1991-92 to 112 and 63 700 in 1992-93. The Trust anticipates that only 53 performances under its community programs will be run in 1993-94 with an expected attendance of 52 400. **The significant downturn in this activity has been attributed by the Trust to reduced government recurrent funding and reduced sponsorship for some programs.**

3.2.107 The Trust expects that its new form of sponsorship, the *Arts Angels*, will assist in the provision of a wider range of services to the broader community and offset the impact of lower government recurrent funding.

3.2.108 Over the years, the Trust has not distinguished between government funding for its community service obligations and the extent to which commercial funding has been applied to meet its obligations in this area.

3.2.109 The Government's 1993-94 *Budget Paper No. 2* outlined its policy on community service obligations and the circumstances under which it would assume funding responsibility where organisations providing commercial operations are required to deliver services other than on a commercial basis. The Government stressed the importance of separate identification of community service obligations so as not to impact adversely on the financial performance of an organisation's commercial operations.

3.2.110 **The Trust should take steps to upgrade the information provided in its Annual Report on the performance of its community service obligations in order to provide the Parliament and the Government with enhanced accountability on this element of its operations.**

□ RESPONSE provided by General Manager, Victorian Arts Centre Trust

While the Trust agrees that transport costs at times prevent students from rural Victoria attending ART-ED programmes, recent restructures of the Victorian Directorate of School Education have affected attendances.

It is true that some free and subsidised programmes had to be reduced in 1992-93, due to reduced sponsorship, in some cases, and general financial stringency. However, community programmes should be considered in conjunction with free programs. The VACT's published performance indicators show an increased target of 370 free events in 1993-94, compared with 341 in 1992-93. In addition, as noted previously, the Arts Angels fundraising initiative introduced in 1994 aims to provide funds for the extension of the Arts Centre's services to a broader cross-section of the community, through more free and subsidised activities.

The Trust will review the content and presentation of statistical information contained in the Centre's Annual Report.

Spire reconstruction

3.2.111 The Centre's spire, which is situated on top of the Theatres' building, is a distinctive landmark which provides a focal point for the promotion of the arts complex.

3.2.112 In 1986, just 2 years following the completion of construction of the Theatres' building, the Trust carried out repairs to reinforce cracked nodes detected in the spire. Since the initial indication of cracking of the nodes, the Trust has, over the years, implemented a program of regular inspections of the spire involving external consultancies and extensive repairs and maintenance.

3.2.113 Consultancy advice to the Trust in January 1992 indicated that the spire in its present state could be considered safe and stable for a period of 5 to 25 years provided regular inspections were undertaken and no further deterioration occurred. However, the consultant indicated that only dismantling and reconstruction would restore the spire to its expected lifespan of 100 years, stipulated in the original design brief.

3.2.114 In March 1994, following the discovery of a fourth cracked node, and on the basis of advice from its engineering consultants, the Trust determined to reconstruct the spire at an estimated overall cost of \$4.4 million. Audit was advised by the Trust that the Government has recently approved allocations of \$2 million for 1994-95 and \$1 million for 1995-96 as funding contributions towards the cost of spire works.

3.2.115 The Trust has pursued since 1987 legal action to recover damages against a number of contractors and consultants because of the defects in the spire. At the date of preparation of this Report, this legal action was still in course.

VICTORIAN GAMING COMMISSION

DEVELOPMENTS IN THE GAMING INDUSTRY

Background

3.2.116 The Auditor-General's *Report on Ministerial Portfolios, May 1993*, provided details of revenue results from the first 7 months of the State's gaming industry. The Report indicated that, to the end of February 1993, aggregate turnover of over \$1.2 billion had been generated from around 7 000 gaming machines installed at approved hotels and clubs, resulting in net income (after returns to patrons) from machines of around \$118 million.

3.2.117 The May 1993 Report also explained how net income from gaming machines is distributed between the Government (Consolidated Fund), the 2 gaming operators, the Trustees of the Will and Estate of the Late George Adams (Tattersalls) and the Totalizator Agency Board (TAB), venue operators (hotels and clubs), and, in the case of hotel venues, the Victorian Gaming Commission (Community Support Fund).

3.2.118 The Report concluded that the early significant levels of revenue derived from gaming reinforced the importance of the Commission's key regulatory role within the industry.

3.2.119 Since the May 1993 Report, 2 important government actions were taken which placed limitations on the rate of growth of the industry. These actions were as follows:

- In June 1993, the Premier announced that a moratorium had been imposed on the issuing of licences for gaming machines to enable a review to be carried out by a special committee of the social and economic impacts of the industry. Under this moratorium, the maximum number of approved machines was temporarily frozen at 15 000 but venue and gaming operators were allowed to fulfil existing contractual obligations for the purchase and installation of machines, subject to the granting of a licence by the Commission.
- Subsequently, in September 1993, the Minister for Gaming issued a directive under the *Gaming Machine Control Act 1991*, which revoked previous directives and limited the maximum number of machines in the State to 20 000 to be shared equally between the 2 gaming operators over a 5 year period from April 1992. The directive also provided that hotels and clubs share equally in the aggregate number of machines to be licensed and for continuation of the requirement that the proportion of machines at venues outside the metropolitan area be not less than 20 per cent. The Minister's action did not change the earlier temporary freeze of 15 000 machines announced by the Premier.

Financial performance of gaming operators in 1992-93

3.2.120 The 2 gaming operators, Tattersalls and the TAB, commenced operations in August and July 1992 respectively. By the end of their inaugural financial reporting period, at 30 June 1993, over 9 800 gaming machines were installed and available to the public at 87 Tattersalls venues (4 400 machines) and at 114 TAB venues (5 400 machines).

3.2.121 Table 3.2I provides details of the financial performance of the 2 gaming operators for the period ended 30 June 1993.

TABLE 3.2I
FINANCIAL PERFORMANCE OF GAMING OPERATORS FOR THE
PERIOD ENDED 30 JUNE 1993
((\$million))

<i>Item</i>	<i>Tattersalls</i>	<i>TAB</i>	<i>Total</i>
Turnover	1 787.9	924.9	2 712.8
Less returned to patrons	1 628.5	828.5	2 457.0
Net income from machines	159.4	96.4	255.8
Less government share -			
Consolidated Fund	53.0	32.1	85.1
Community Support Fund	9.0	4.5	13.5
Less venue operators share	44.3	27.4	71.7
Retained by gaming operators	53.1	32.4	85.5
Less operating expenses	22.5	25.9	
interest expense	3.3	2.9	
Net profit before abnormal expenses	27.3	3.6	
Less abnormal expenses	-	59.2	
Net profit/(loss) for year	27.3	(55.6)	

3.2.122 It can be seen that, in the industry's first year of operations, the 2 gaming operators generated aggregate turnover of \$2.7 billion, with over \$2.4 billion or around 90.6 per cent returned to patrons.

3.2.123 The relative market shares for the 2 operators, in terms of their turnover to 30 June 1993, were 65.9 per cent for Tattersalls and 34.1 per cent for the TAB. These market shares essentially reflected the public preference for Tattersalls cash-based gaming machines as against the TAB's initial use of card-only machines and its later modification of some machines to accommodate coin operation.

3.2.124 As explained in the section of this Report dealing specifically with the TAB, a new Board became responsible for the strategic management and control of the TAB from 1 June 1993. The new Board subsequently introduced several important changes to the TAB's strategic direction and, following this action, the TAB's 1992-93 financial statements included abnormal expense adjustments totalling \$96 million. Of this amount, \$59.2 million related to the TAB's gaming operations in the period to 30 June 1993 and reflected decisions taken by the new Board to cease the development of sophisticated gaming systems and to decommission a significant number of its machines in favour of the more popular NSW-style cash-operated machines.

3.2.125 In almost 12 months, the State's 2 gaming operators generated revenue of \$85.1 million for the Consolidated Fund with more than 62 per cent (\$53 million) derived from the operations of Tattersalls.

Gaming revenue results to March 1994.

3.2.126 The Government's 1993-94 *Budget Paper No. 4* indicated that the Consolidated Fund's share of gaming revenue for the financial year was estimated at \$193 million, on a cash basis. This estimate envisaged an increase of 135 per cent in gaming revenue for the current year and reflected the progressively increasing numbers of machines approved under licences issued by the Commission for the gaming network.

3.2.127 Table 3.2J provides details of turnover, net income from machines (after returns to patrons), and distribution of net income to the Government and venue and gaming operators as at 12 March 1994, together with statistics on the number of approved operating venues and gaming machines at that date.

TABLE 3.2J
GAMING STATISTICS AS AT 12 MARCH 1994

Item		Hotels	Clubs	Total
Turnover	(\$m)	3 083.9	1 598.7	4 682.6
Less returned to patrons	(\$m)	2 793.2	1 443.0	4 236.2
Net income from machines	(\$m)	290.7	155.7	446.4
Less government share -				
Consolidated Fund	(\$m)	96.9	51.9	148.8
Community Support Fund	(\$m)	24.2		24.2
Less venue operators' share	(\$m)	72.7	51.9	124.6
Retained by gaming operators before expenses	(\$m)	96.9	51.9	148.8
Number of venues		140	165	305
Number of machines		7 198	6 065	13 263

3.2.128 As indicated in the above Table, by 12 March 1994, just over 8 months into the 1993-94 financial year, aggregate turnover from gaming operations had almost reached \$4.7 billion and over 13 200 machines had been installed at approved hotels and clubs. Based on the level of turnover generated to date, aggregate turnover for the 1993-94 year is likely to be well in excess of \$6 billion.

3.2.129 The above Table also shows that turnover generated from hotel venues is almost double the turnover from clubs even though the number of machines installed in hotels was only 20 per cent more than the number installed in clubs.

3.2.130 Audit was recently advised by the Department of the Treasury that the Consolidated Fund's share of 1993-94 gaming revenues is now estimated to be \$218 million in lieu of the earlier budgeted figure of \$193 million. This anticipated increase in revenue for the year is based on the installation of additional machines in hotels and clubs and the maintenance of current levels of turnover per machine.

3.2.131 During 1993-94, the gaming industry has continued to generate significant levels of turnover. The Consolidated Fund's share of revenue to 12 March 1994 totalled \$148.8 million with over 66 per cent (\$98.4 million) derived from the operations of Tattersalls.

Analysis of Community Support Fund

3.2.132 As outlined in the Auditor-General's *Report on Ministerial Portfolios, May 1993*, the distribution of net income from gaming machines installed in hotels (after returns to patrons) differs from the position with clubs in that the venue operator's share from hotels is 25 per cent of net income, compared with the 33.3 per cent with clubs. The remaining 8.3 per cent in the case of hotels is paid into the Community Support Fund, a Trust Fund maintained in the Public Account.

3.2.133 Under the gaming legislation, moneys in the Community Support Fund may be applied, subject to ministerial approval, **firstly**, to meet the administrative expenses of the Commission and, **secondly**, for purposes of its research relating to the social impact of gambling. Of the balance remaining in the Fund, 70 per cent is available for distribution, in accordance with the legislation, for:

- the benefit of sport and recreation clubs or programs; and
- the provision of financial counselling services, support and assistance for families in crisis or programs for the prevention of compulsive gambling or for the treatment or rehabilitation of persons who are compulsive gamblers or towards government initiatives on homeless youth.

3.2.134 The remaining balance within the Fund can be utilised for the promotion of the arts and of tourism.

Approved distributions for 1992-93

3.2.135 For the period to 30 June 1993, amounts credited to the Fund totalled \$13.5 million. Table 3.2K provides details of the distributions from the Fund as approved by the Minister under the terms of the legislation.

TABLE 3.2K
COMMUNITY SUPPORT FUND APPROVED
DISTRIBUTIONS FOR 1992-93
(\$'000)

<i>Distributions</i>	<i>Amount</i>
Total credits to the Fund	13 532
Less Victorian Gaming Commission -	
Administrative expenses	6 848
Research into social impact of gambling	13
	6 861
Less specific distributions -	
Sport and Recreation -	
State Swimming Centre	1 625
1995 Australian Masters Games	125
Albert Park squash court	90
Health and Community Services -	
Street Kids policy initiative	1 000
Tourism -	
Ski Victoria promotions	600
Arts -	
Victoria State Opera	690
Moomba	80
	4 210
Undistributed balance of Fund at 30 June 1993	2 461

3.2.136 At the date of preparation of this Report, all 1992-93 distributions (after the administrative and research expenses of the Commission) had been drawn down from the Fund by the responsible Departments, with the exception of the amount of \$1 million approved for distribution under the Government's Street Kids policy initiative. Audit was advised by the Department of Health and Community Services that arrangements will shortly be made for the Consolidated Fund to be reimbursed for an amount of \$1 million allocated to the Street Kids initiative under the Commonwealth-State Supported Accommodation Assistance Program.

3.2.137 Relevant details of the more significant distributions from the Fund are summarised below:

- *Sport and Recreation.* The amount of \$1.6 million was paid into a new Trust Fund, the *State Swimming Centre Development Account*, managed by the Department of Arts, Sport and Tourism, to be applied towards the development of a new State Swimming Centre. **At the date of preparation of this Report, the total amount was unexpended.** The Department has advised that application of the amount credited to the new Trust Fund is likely to be deferred until a final decision has been reached by the Government on the location of a new State Swimming Centre.
- *Arts.* The amount of \$690 000 was paid into the Consolidated Fund as an initial repayment of a loan of \$2.4 million provided by the Government during 1993 to the Victoria State Opera under a special financial assistance package to that arts organisation.

Audit has been advised by the Department that the balance of the loan, \$1.7 million, will be repaid during 1993-94 to the Consolidated Fund from the Community Support Fund. The Department expects that loan repayments from the Victoria State Opera will be applied for arts purposes as determined by the Minister for the Arts.

- *Tourism.* An amount of \$600 000 was paid to the Victorian High Country Promotion Council (known as Ski Victoria) during 1993 to undertake the 1993 winter marketing campaign, including television and print media advertising, for the Victorian alpine area.

3.2.138 Notwithstanding the significance accorded by the legislation to research relating to the social impact of gambling, an amount of only \$13 000 had been specifically applied for this purpose as at 30 June 1993. This position essentially reflected the Government's policy of awaiting the outcome of the deliberations of its special review into the social and economic impacts of the industry.

Approved distributions to 12 March 1994

3.2.139 The Department of the Treasury estimates that total credits to the Fund for 1993-94 will be in excess of \$35 million. The Commission expects that, for 1993-94, its administrative expenses and special research costs into gambling will amount to \$9 million and \$235 000 respectively (this latter amount includes \$154 000 earmarked to meet the expenses of the Government's special committee on gaming). As previously indicated, the gaming legislation provides that the expenses of the Commission have a first charge on moneys credited to the Fund. Based on the Department of the Treasury's estimate of total credits to the Fund of \$35 million, an amount of around \$26 million is likely to be available from gaming operations during 1993-94 for distribution to the remaining areas specified in the legislation.

3.2.140 By 12 March 1994, an amount of \$24.2 million (before the Commission's expenses) had been credited to the Fund from 1993-94 gaming operations. In March 1994, the Minister approved further distributions from the Fund totalling \$7.8 million. These latest distributions comprise an amount of **\$4.9 million for community services programs** (homeless youth crisis accommodation, \$2.5 million; families in crisis, \$1.5 million; compulsive gambling, \$800 000; and foodbank, \$100 000) and grants totalling **\$2.9 million to various arts organisations**. **At the date of preparation of this Report, the total amount of \$7.8 million approved for distribution had not been drawn from the Fund.**

3.2.141 Audit was advised by the Department of Arts, Sport and Tourism that the distributions for community services programs represent initial allocations from the Fund under a 3 year Government strategy, involving total funding of \$12.6 million; for 3 key programs (homeless youth crisis accommodation, \$4.2 million; families in crisis, \$1.9 million; and compulsive gambling, \$6.5 million).

3.2.142 It can be seen that distributions from the Fund involve financial transactions of considerable magnitude. In addition, a range of public sector organisations have responsibility for the management of distributions.

3.2.143 Such circumstances reinforce the importance of an effective management and accountability framework which ensures that the periodic allocations from the Fund are adequately coordinated. In addition, the resultant outcomes, measured against appropriate benchmarks, need to be systematically monitored, with results reported each year to the Parliament and the community.

3.2.144 The Department of Arts, Sport and Tourism advised audit that it has recently initiated action to ensure that the administration of funds distributed from the Community Support Fund and related reporting processes are effectively managed.

Establishment of Gaming Review Committee

3.2.145 As indicated in an earlier paragraph, the Premier announced in June 1993 that the Government proposed to establish a special committee to examine the social and economic impacts of the gaming industry.

3.2.146 In September 1993, the Minister provided details of the membership of the committee and its terms of reference. The Minister stated that the committee would be chaired by the then Public Service Commissioner and would review and make recommendations on the introduction and operation of gaming machines in Victoria, having particular regard to:

- *the costs and benefits for the community and the State arising from electronic gaming machines;*
- *the need for viability within the gaming industry;*
- *the need for effectiveness and efficiency in the regulatory and managerial framework governing the introduction and operation of electronic gaming machines; and*
- *any other matter considered to be of relevance by the review.*

3.2.147 The Minister indicated that the review was expected to be finalised by no later than March 1994. An amount of \$154 000 (\$37 000 expended to 31 March 1994) was allocated by the Commission from its special research fund relating to the social impact of gambling to cover the various costs of the review.

3.2.148 **At the date of preparation of this Report, the outcome of the deliberations of the review committee had not been publicly released.**

TOTALIZATOR AGENCY BOARD**SIGNIFICANT CHANGES IN MANAGEMENT STRATEGIES AT THE TAB****Background**

3.2.149 In May 1993, the Minister for Sport, Recreation and Racing announced the composition of a new Board of management for the TAB which became responsible for the organisation's strategic management and control from 1 June 1993.

3.2.150 Following assessment of business strategies in place and operations of the TAB for the almost completed 1992-93 year (to end on 31 July 1993), the Board quickly identified the need for key changes in strategic directions for the organisation. This action was heavily influenced by a major deterioration in the performance of its gambling operation at Tabaret at Rialto, difficulties with the development of a new computerised wagering system known as DELTA (to replace the ageing CRISP system) and indications from early gaming revenue figures that the TAB's competitor, with less gaming machines, was outperforming the TAB by a significant margin.

3.2.151 In essence, the Board determined to focus on its role as a wagering and gaming operator and cease the organisation's past involvement in the development of sophisticated wagering and gaming computer systems. Consequently, all systems development was brought to a halt and a consultant, DMR Group Australia Pty Ltd was engaged to evaluate and report on the development of DELTA. In addition, the Board determined that it would revise the Tabaret at Rialto operation and seek to install a venue operator to manage the outlet, recognising that the TAB was committed to significant future leasing costs at the premises. In relation to gaming machines, the Board determined that, in view of the poor performance of its machines, it would decommission a significant number of these machines in favour of the more popular NSW-style, cash-based machines.

3.2.152 As a consequence of the above determinations of the new Board, the TAB's financial statements for 1992-93, which were formally adopted by the Board on 5 October 1993, reflected major adjustments in the form of several abnormal expense items with an aggregate total of \$96 million, embracing wagering, Tabaret at Rialto and gaming operations. After accounting for these adjustments, the TAB reported a net profit for the year of only \$14 million, a reduction of \$97.5 million compared with the reported profit (\$111.5 million) in 1991-92.

3.2.153 The Board's final decision on these abnormal adjustments was significantly influenced by the results of the DMR review and a major consultancy by the chartered accounting firm KPMG Peat Marwick, commissioned by the Board, to review the TAB's profit and loss statement and balance sheet and the accounting policies underpinning these statements.

3.2.154 Advice of the Board's intention to adopt the abnormal adjustments in the 1992-93 financial statements was first conveyed to audit on 4 October 1993, immediately prior to formal adoption by the Board of the accounts.

3.2.155 The significance and timing of the Board's decision on the abnormal adjustments automatically created a need for extensive audit scrutiny before the independent external audit opinion could be expressed on the financial statements by the Auditor-General on behalf of the Parliament.

3.2.156 On 7 October 1993, the Minister announced an intention to amend the *Racing Act* 1958 to provide for a distribution of \$83.5 million to the racing industry from wagering operations for 1992-93. The Minister indicated that the amendment was necessary to enable the TAB to draw on its capital reserves of \$36.9 million, in view of the reduced surplus available for distribution to the industry. The amendment was subsequently passed by the Parliament and proclaimed to operate from 28 October 1993.

Audit consideration of abnormal adjustments

3.2.157 During October 1993, several meetings and exchanges of correspondence took place between audit and the TAB, where information was sought and provided in support of the abnormal adjustments. In this regard, the nature and late timing of the Board's decision meant that it was necessary for audit to carefully consider whether the action related to conditions prevailing at balance date and therefore justified their inclusion in the 1992-93 financial statements or represented key strategic measures directly associated with the following year's operations.

3.2.158 Table 3.2L summarises the abnormal adjustments which were reflected in the 1992-93 financial statements of the TAB.

TABLE 3.2L
ABNORMAL ADJUSTMENTS
('\$000)

<i>Item</i>	<i>Amount</i>	
Wagering		
Racing operations -		
EDP systems (DELTA) -		
software development costs	3 790	
deferred (previously capitalised) expenditure	3 526	7 316
Premises improvements in retail sales network		2 387
Provision for re-organisation costs		3 500
Provision for contractual commitments relating to wagering systems development		1 008
Additional depreciation - handytab terminals		1 012
		15 223
Tabaret at Rialto -		
Premises improvements and EDP systems	9 932	
Deferred (previously capitalised) expenditure	1 883	11 815
Estimated leasing losses		9 900
		21 715
Total Wagering		36 938
Gaming		
EDP systems -		
gaming machines	37 848	
gaming systems software	10 686	48 534
Deferred (previously capitalised) expenditure		10 436
Gaming account card obsolescence		130
Total Gaming		59 100
Total adjustments		96 038

3.2.159 The following paragraphs outline the results of the audit examination of the various abnormal adjustments.

Adjustments accepted after initial examination

EDP systems (DELTA) - write-off of software development costs and previously capitalised expenditure - \$7.3 million

3.2.160 Following examination of the Board's new direction for DELTA and material in the DMR report on the system, which indicated inadequate design, poor management and control and protracted and costly development time spent on the project, audit accepted that it was appropriate to write-off past software development costs and deferred expenditure. At the time of signing the financial statements, it was the Board's intention to utilise the computer hardware purchased by the previous Board for the DELTA system.

Tabaret at Rialto - Write-down of premises improvements, EDP systems and previously capitalised expenditure - \$11.8 million and accelerated recognition as an expense of estimated future losses arising from leasing conditions - \$9.9 million

3.2.161 Tabaret at Rialto is a gambling centre of the TAB, established under the *Racing Act 1958*, which operates in leased premises at a major hotel located in the central business district of Melbourne. It commenced operations in November 1990, 20 months before gaming machines were introduced in Victoria.

3.2.162 The abnormal adjustments totalling \$21.7 million involved:

- write-down in the carrying value of the asset items, premises improvements and EDP systems, by a total of \$9.9 million ;
- the write-off as an expense, of previously capitalised expenditure of \$1.9 million; and
- accelerated recognition, as an expense, of future leasing costs net of estimated recoveries (\$9.9 million) from the planned revision of venue operations.

3.2.163 The following factors were relevant to the audit examination and acceptance of these adjustments:

- a major decline in profitability of the centre, before abnormal items, from **\$10.6 million** in 1991-92 to **\$700 000** in 1992-93;
- an expanding gaming industry within the central business district in direct competition to the centre and the emerging competitive threat from a significant casino operation within walking distance of the centre;
- a legislative restriction of a fixed player return at 88 per cent, compared with a higher return available to patrons at gaming venues;
- computer software at the centre was not compatible with the TAB's gaming network and would need to be upgraded and maintained by the TAB, action which would be inconsistent with the Board's new direction; and
- an expensive licence agreement with provisions restricting the TAB's ability to effect changes to the leased premises and obligating the TAB to pay leasing costs for a further 11 years.

3.2.164 Having regard to the above factors, and signs of a continuing steady decline in turnover after balance date at Tabaret at Rialto, audit concluded that the accounting treatment was consistent with International Accounting Standard No 10, *Contingencies and Events Occurring After the Balance Sheet Date*.

Write-off of gaming capitalised expenditure - \$10.4 million

3.2.165 Audit accepted that, given the new business strategy of the Board to focus on the TAB's core responsibilities as a gaming operator rather than a system developer, it would not be prudent for expenditure of \$10.4 million, capitalised in previous years in respect of gaming operations, to continue to be deferred.

Additional depreciation of Handytabs terminals - \$1 million

3.2.166 As the handytabs terminals (self-service betting) were integrally linked to the current CRISP computer system and would be unlikely to be transferred to any new system, the Board considered that it was appropriate to reassess the depreciation of the terminals over a shorter remaining useful life. On this basis, audit considered the adjustment to be reasonable.

Adjustments accepted after further discussions with Board

3.2.167 By 26 October 1993, further discussions with the Board were necessary before a final audit position on the remaining abnormal expense items could be reached. The following adjustments were accepted by audit after these discussions.

Write down of gaming machines - \$37.8 million

3.2.168 In view of the substantially greater market share and higher returns of TAB's competitor, the Board decided to introduce NSW-styled machines as soon as possible and to retire 3 600 existing gaming machines. In addition, the Board determined to persist in the short-term with 3 000 remaining machines to be upgraded, conditional upon a review in 12 months to determine their long-term viability within the network.

3.2.169 In the further discussions on this quite significant adjustment to the carrying value of gaming machines, audit advised the Board that the following evidence was necessary to support the write off action:

- formal endorsement by the Board before 31 July 1993 of the planned revised mix of gaming machines; and
- clear progress in the implementation of its machine replacement program.

3.2.170 On 26 October 1993, the Chairman advised the Auditor-General that a meeting of the Board held on 18 June 1993 had clearly determined to proceed with the strategies which had led to the write-downs. The Chairman also advised that the Board had resolved not to document the minutes of its June meeting. On 27 October 1993, audit received correspondence from the Chairman which provided a record of the discussions and resolutions of the meeting of 18 June. These discussions and resolutions were not formally ratified by the Board until its meeting on 26 October 1993.

3.2.171 In addition, the Board made available to audit details of its machine replacement program which identified that all machines were expected to be replaced by the end of February 1994. The Board also provided details of estimated net cashflows anticipated to be generated by the replaced machines during 1993-94.

3.2.172 This evidence provided by the Board was examined by audit with particular attention directed to the impact of timing of the replacement program. Further, audit physically inspected gaming machines withdrawn from the network to verify the start of action under the replacement strategy. On the evidence provided and the resultant audit examination, the write-down of \$37.8 million in the value of the replaced machines was considered to be acceptable.

Write down of gaming system software - \$10.7 million

3.2.173 In view of its changed direction to focus on operations rather than systems development, the Board determined that it would dispose of gaming systems software and transfer responsibility for maintenance and upgrade of the software to an outside party. This adjustment represented a reduction in the value of the software on the basis of expected sale proceeds after allowance for the Board's intention to retain rights for use of the software in Victoria. The Board agreed that if this strategy could not be implemented, the TAB would replace the existing system with new software which was under development by an external supplier to run NSW-style machines in parallel with the existing system.

3.2.174 In the circumstances, the write-down of software value, based on expected sale proceeds in line with the relative cost of similar software available for purchase off-the-shelf, was considered by audit to be reasonable.

Adjustments not accepted by audit

3.2.175 The **write-down of premises improvements** in the retail sales network of \$2.4 million was not accepted by audit as no substantive action had been taken at balance date and there had been no significant impairment in the carrying value of the existing agency network.

3.2.176 The **provision for reorganisation** of \$3.5 million constituted costs expected to be incurred by the Board from its planned restructuring and staff downsizing. Audit did not accept this item as a firm obligation did not exist at balance date in respect of the reorganisation.

3.2.177 Audit determined to accept half (\$0.5 million) of the **provision for contractual commitments** for wagering systems development which related to firm contractual obligations at balance date with external systems development contractors. However, in relation to the remaining \$0.5 million for DMR services, which essentially was for review of DELTA and project management, audit considered that a firm obligation did not exist at balance date as the consultancy had not been commissioned until August 1993.

3.2.178 Having regard to the materiality of items not accepted by audit, a confirming opinion was provided on the 1992-93 financial statements of the TAB by the Auditor-General on 29 October 1993.

3.2.179 Clearly, successful implementation by the Board during 1993-94, and beyond, of its new strategies relating to Tabaret at Rialto and the gaming machine replacement program will be critical to the future profitability of the TAB's gaming operations. In this respect, the TAB's audited 1993-94 financial statements will assume particular significance as an early source of information on the relative success of the Board's new strategic direction.

Public float of the TAB

3.2.180 In December 1993, the Premier outlined the Government's proposal to float the TAB on the stock exchange on the basis of the racing industry taking up 25 per cent of shares with the remainder to be made available to the public. The announcement indicated that full financial details would be provided in the float's prospectus before 30 June 1994 and that shares would be traded before the 1994 spring racing carnival.

3.2.181 The Premier's announcement also mentioned an intention to reduce the Government's commission on wagering from an average of 6.7 per cent to 4.5 per cent to more closely equate with the Commission on other forms of gambling.

3.2.182 On 15 March 1994, following a period of negotiations between the Government and the racing industry, the Premier announced that the 2 parties had signed a Memorandum of Understanding under which:

- 100 per cent of the TAB would now be floated;
- a new company (TAB Co) and the racing industry would form an unincorporated joint venture, owned 75 per cent by TAB Co and 25 per cent by the racing industry (Race Co);
- TAB Co would be the manager and provide the assets, and receive 75 per cent of the joint venture's distribution of profits; and
- a management committee would be established with equal representation from TAB Co and Race Co and unanimous agreement between the 2 parties would be required for decisions of the joint venture to be carried.

3.2.183 The main conditions attaching to the float, as stated by the Government, will be a 40 per cent ceiling on foreign investment, a restriction of a maximum of 5 per cent of shares for individual shareholders, and provision for discounted access to the float to be given to TAB staff and agents, and the 40 000 members of Victorian racing clubs.

3.2.184 Currently, the racing industry is entitled to TAB revenues under the *Racing Act* 1958 in the form of a distribution of the TAB's net operating profit, subject to a minimum of 3.525 per cent of off-course turnover. For capital purposes, funds have been provided from development funds administered by the Office of Racing, within the Department of Arts, Sport and Tourism.

3.2.185 The Government expects that the racing industry will receive in excess of \$150 million each year under the new arrangements, made up of a base figure of \$50 million to be indexed to growth in net wagering revenue, 18.8 per cent of net wagering revenue of TAB Co and 25 per cent of the joint venture's profits.

3.2.186 In effect, the existing legislative framework will be replaced with one which provides for:

- direct participation by the racing industry in the TAB through the proposed joint venture;
- transfer of responsibility for the development funds from the Office of Racing to the racing industry; and
- sharing by the racing industry in future gaming profits of TAB Co.

3.2.187 The Government expects to utilise its share of the float proceeds to reduce State debt, with the balance of the proceeds available to TAB Co as an injection to its capital reserves.

3.2.188 The March 1994 statement issued by the Premier also indicated that legislation governing the sale of the TAB was under preparation and would be introduced to the Parliament during the current Autumn session.

□ RESPONSE provided by Chief Executive, Totalizator Agency Board.

We have reviewed the audit report in detail and consider it to be factually correct.

LOSSES, THEFTS AND IRREGULARITIES

Unauthorised credit betting by agents

3.2.189 During the period January 1993 to March 1994, 10 instances of unauthorised betting by agents and pubtabs were reported to audit by the Board. The net loss to the Board totalled \$220 900 of which \$177 400 has been recovered and action has been taken to obtain full restitution of the balance.

Thefts of funds

3.2.190 A number of robberies and burglaries with losses totalling \$139 900 occurred at retail sales outlets during the same 15 month period, with \$64 800 recovered and a further amount of \$25 500 subject to insurance claim.

Other losses incurred

3.2.191 The Board has been subject to other irregularities relating to the further unauthorised use of telebet accounts and to instances of cash shortages at agencies. Losses of in excess of \$68 000 have been incurred by the Board with an amount of \$17 000 having since been recovered and action taken for full restitution of the remaining balance.

3.2.192 In April 1993, central monitoring by Board staff of gaming machine activity indicated an exceptional pattern on machines in various venues in respect of the Lucky 7s and Lucky 8s games. Board investigations revealed deficiencies in the self-play feature of the machines and these faults have since been rectified.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
MATTERS RESOLVED OR ACTION COMMENCED		
DEPARTMENT OF ARTS, SPORT AND TOURISM		
<i>Ministerial Portfolios, May 1993, pp. 38-41.</i>	Need for the 3 Boards responsible for the racing industry's development funds to closely monitor the impact of gaming machines on the availability of funds for future capital projects.	Up to 1994, the growth in development funds has been sufficient to meet the immediate needs of the racing industry. The 3 Boards are closely monitoring the level of funds available for future projects.
<i>Ministerial Portfolios, May 1993, pp. 43.</i>	Prompt action is necessary to establish a satisfactory accountability framework for Cranbourne training complex.	A lease agreement between the committee of management and the Cranbourne Turf Club has been signed but Governor-In-Council approval is still to be given. Separate accounting records have not yet been established for the complex.
SWAN HILL PIONEER SETTLEMENT		
<i>Ministerial Portfolios, May 1989, pp. 166. May 1992, pp. 334-5.</i>	Decisive action is needed to resolve the financial viability of the Authority.	Financial statements for 1991-92 and 1992-93 are still not available for audit. A recent visit by audit to the Authority has found the position from both legislative and accounting viewpoints to be rather inconclusive. Tourism Victoria is currently pursuing avenues to resolve the matter.
TOURISM VICTORIA		
<i>Ministerial Portfolios, May 1993, pp. 47-9.</i>	Need for further investigation of an irregularity relating to the purchase of a computer.	Advice obtained by Tourism Victoria from the Victorian Government Solicitor indicated that further action was not warranted on the basis of insufficient evidence. Tourism Victoria has taken action to strengthen its procedures to prevent recurrence.

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS				
Department of Arts, Sport and Tourism	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	9 Oct. 1993	23 Oct. 1993
ARTS				
Council of the Museum of Victoria	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	29 Sept. 1993	30 Sept. 1993(a)
Council of the State Library of Victoria	30 June 1993	" "	29 Sept. 1993	30 Sept. 1993(a)
Council of Trustees of the National Gallery of Victoria	30 June 1993	" "	13 Sept. 1993	28 Sept. 1993(a)
Film Victoria	30 June 1993	" "	27 Sept. 1993	29 Sept. 1993(a)
Geelong Performing Arts Centre Trust	30 June 1993	" "	15 Sept. 1993	30 Sept. 1993(a)
State Film Centre of Victoria Council	30 June 1993	" "	17 Sept. 1993	28 Sept. 1993(a)
Victorian Arts Centre Trust	30 June 1993	" "	29 Sept. 1993	30 Sept. 1993 (a)
GAMING				
TAB Gaming Business Segment	30 June 1993	31 Oct. <i>Gaming Machine Control Act 1991, s.132.</i>	7 Oct. 1993	29 Oct. 1993
Tattersall Gaming Machine Division	30 June 1993	" "	5 Oct. 1993	6 Oct. 1993
Victorian Casino Control Authority	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	5 Sept. 1993	15 Sept. 1993
Victorian Gaming Commission	30 June 1993	" "	21 Sept. 1993	22 Sept. 1993

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
SPORT, RECREATION AND RACING				
Greyhound Racing Control Board	31 July 1993	31 Oct. <i>Annual Reporting Act 1983, s.9.</i>	14 Oct. 1993	15 Oct. 1993
Harness Racing Board	31 July 1993	" "	22 Oct. 1993	29 Oct. 1993
National Tennis Centre Trust	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	21 Sept. 1993	30 Sept. 1993
Totalizator Agency Board	31 July 1993	31 Oct. <i>Annual Reporting Act 1983, s.9.</i>	5 Oct. 1993	29 Oct. 1993
Victorian Institute of Sport Ltd	30 June 1993	No reporting requirements. Audit conducted at request of Treasurer.	15 Sept. 1993	22 Sept. 1993
Victorian Institute of Sport Trust	30 June 1993	" "	15 Sept. 1993	22 Sept. 1993
Victorian Sports Facilities Foundation Ltd (b)	Period 11 Sept. 1992 to 14 April 1993	" "	3 May 1993	13 Aug. 1993
TOURISM				
Emerald Tourist Railway Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	15 Sept. 1993	29 Sept. 1993
Tourism Victoria	30 June 1993	" "	13 Sept. 1993	30 Sept. 1993
INCOMPLETE AUDITS				
TOURISM				
Swan Hill Pioneer Settlement Authority	30 June 1992 and 1993	31 Oct. <i>Annual Reporting Act 1983, s.9.</i> Initial extension granted to 30 April 1993. No further extension granted.	Financial statements still not received.	

(a) Qualified audit report issued.

(b) The Government determined to cease the operations of the company with effect from 14 April 1993.

Part 3.3

Business and Employment

KEY FINDINGS

DEPARTMENT OF BUSINESS AND EMPLOYMENT

Workplace Health and Safety

- The Occupational Health and Safety Authority's workplace inspection program relating to targeted industries and activities was not based on a sound risk-based planning framework.
Paras 3.3.17 to 3.3.22
- As information developed by the Authority relating to workplace health and safety standards was not widely distributed, employers may not be fully aware of their responsibilities or in a position to effectively identify health and safety problems within their workplaces.
Paras 3.3.23 to 3.3.27
- At March 1994, 60 per cent of the 32 500 higher-risk boiler and pressure vessels had not been inspected by the Authority within the intervals specified under the legislation.
Paras 3.3.37 to 3.3.39
- During 1992-93, the time spent by Authority inspectors within workplaces only accounted for 26 per cent of the total available days.
Paras 3.3.40 to 3.3.42
- In the absence of an established benchmark, the Authority is not in a position to effectively assess whether the number of inspections undertaken was adequate to address the workplace risks within the targeted industries. Accordingly, audit could not ascertain whether sufficient workplace visits were undertaken or whether the current inspectorial workforce was in excess of requirements.
Paras 3.3.40 to 3.3.42
- Consideration needs to be given to a comprehensive review to investigate the potential for integration of the activities of the Occupational Health and Safety Authority and the Victorian WorkCover Authority.
Paras 3.3.48 to 3.3.52

KEY FINDINGS - *continued*

Workplace Health and Safety - *continued*

- There is a need for the Authority to develop more specific indicators that will enable greater accuracy in the assessment of its performance in preventing workplace injuries.

Paras 3.3.53 to 3.3.56

CONSTRUCTION INDUSTRY LONG SERVICE LEAVE BOARD

Administration of the Fund

- Although the Construction Industry Long Service Leave Board has gradually reduced employer contributions since December 1989 and then waived such contributions in December 1993, the level of surplus net assets has continued to increase and totalled \$144 million at June 1993.

Paras 3.3.64 to 3.3.86

- The percentage of funds available to meet actuarially assessed long service leave liabilities was 230 per cent at June 1993 compared with the Board's prudential targeted funding ratio of 130 per cent.

Paras 3.3.64 to 3.3.67

- The Board has managed the Construction Industry Long Service Leave Fund efficiently and effectively, with adequate procedures and practices established to ensure the proper administration of the portable long service leave scheme, the optimisation of investment returns and compliance with the Board's governing legislation.

Paras 3.3.69 to 3.3.92

VICTORIAN WORKCOVER AUTHORITY

Financial viability of the State's workers' compensation scheme

- Government reforms have been successful in redressing the poor financial position of the State's workers' compensation scheme with the Government's key financial objective of a fully-funded position now likely to be achieved within 2 years.

Paras 3.3.93 to 3.3.110

3.3.1 Six Ministers, namely the Minister for Industry and Employment, the Minister for Industry Services, the Minister for Regional Development, the Minister for Small Business, the Minister responsible for WorkCover and the Minister responsible for Youth Affairs, have responsibility for operations within the Business and Employment sector. These Ministers have collective responsibility for the Department of Business and Employment.

3.3.2 Details of the specific ministerial responsibilities for public bodies within the Business and Employment sector are listed in Table 3.3A. These public bodies, together with the Department of Business and Employment, are subject to audit by the Auditor-General.

TABLE 3.3A
MINISTERIAL RESPONSIBILITIES WITHIN THE
BUSINESS AND EMPLOYMENT SECTOR

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Industry and Employment	Exhibition Trustees Overseas Projects Corporation of Victoria Ltd
Industry Services	Construction Industry Long Service Leave Board
Regional Development	Albury/Wodonga (Victoria) Corporation Geelong Regional Commission (a) Latrobe Regional Commission
Small Business	Liquor Licensing Commission Small Business Development Corporation
WorkCover	Victorian WorkCover Authority
Youth Affairs (b)	-

(a) The Commission was abolished on 3 December 1993 following repeal of the *Geelong Regional Commission Act 1977*.

(b) Minister has responsibility for certain functions of the Department of Business and Employment.

3.3.3 Comment on matters of significance arising from the audit of certain of the above entities is provided below.

DEPARTMENT OF BUSINESS AND EMPLOYMENT

WORKPLACE HEALTH AND SAFETY

3.3.4 Over the past decade, health and safety in the workplace has become an issue of significant community interest. In financial terms, the benefits of a safe workplace are clearly evident in that the direct and indirect costs to the Victorian community arising from workplace injury and illness during 1992-93 are estimated by the Occupational Health and Safety Authority at \$5 billion.

3.3.5 The Department of Business and Employment, through its Health and Safety Division and Chemicals and Plant Safety Division, is responsible for ensuring the maintenance of acceptable standards of workplace health and safety by employers in Victoria. The 2 Divisions operate under the business name *Occupational Health and Safety Authority*, and administer the *Occupational Health and Safety Act 1985*, the *Dangerous Goods Act 1985* and other associated legislation.

3.3.6 The *Occupational Health and Safety Act 1985* places primary responsibility for ensuring health and safety in the workplace with employers. Accordingly, employers have a duty, as far as practicable, to identify and resolve workplace safety problems. The Authority's role is to assist employers and employees to establish a safe workplace and ensure compliance with the relevant legislation. At June 1993, there were 185 000 employers engaged in 515 industry categories in the State.

3.3.7 The framework established under the legislation is consistent with the national trend in workplace health and safety administration. In line with this framework, the Government during 1994 plans to repeal related legislation such as the *Boiler and Pressure Vessels Act 1970*, *Lifts and Cranes Act 1967* and the *Scaffolding Act 1971* which contain prescriptive health and safety requirements, to bring employers subject to this legislation under the more general workplace health and safety requirements of the *Occupational Health and Safety Act 1985*.

3.3.8 While the Authority has responsibility for facilitating a safe workplace environment, the Victorian WorkCover Authority is responsible for administering the State's workers' compensation insurance scheme.

3.3.9 The Occupational Health and Safety Authority's objectives, as stated in its 1993-94 Business Plan are to:

- *"reduce the incidence and severity of work-related injury and disease;*
- *reduce the risks to the public which arise from the use of dangerous goods and specific equipment and devices;*
- *target and reduce the potential for major injuries in Victorian workplaces; and*
- *establish and maintain a commitment to quality of service and continuous improvement of service".*

3.3.10 During 1993-94, audit conducted a review of the operations of the Authority to assess its effectiveness in facilitating the maintenance of a safe workplace environment by employers within the State. The scope of the review did not cover the Authority's responsibilities in relation to dangerous goods.

3.3.11 In assessing the effective operation of a workplace health and safety system that places primary responsibility on employers, audit sought to establish whether:

- workplace health and safety guidelines and performance criteria had been developed and made available to all employers on a regular basis to enable regular self-assessment;
- workplace inspections were being planned and undertaken using a risk-based approach;
- adequate penalties had been imposed for non-compliance with established workplace health and safety requirements; and
- there was a direct correlation between workers' compensation insurance premiums and employers' health and safety performance.

3.3.12 In March 1994, the Department of Business and Employment advised that a review of the operations, structure and service delivery of the Authority is to be undertaken by consultants with a view to recommending improvements to the quality and efficiency of the Government's occupational health and safety program. It is expected that the review will be completed in May 1994.

OVERALL CONCLUSION

3.3.13 The key activities of the Authority relating to injury prevention are primarily focused on targeted industries and activities, inspections of specified equipment, and investigations of workplace accidents and incidents. In relation to the targeted industries and activities, audit found that only 12 per cent of the Authority's workplace inspection program was based on a structured planning framework. Furthermore this framework, an internally developed prevention model, was deficient in that it was based on historical injury and cost data, and ignored adverse trends and various inherent risks. The balance of the Authority's workplace inspection activity, was not targeted to employers using a sound risk-based planning framework.

3.3.14 The Authority was not in a position to assess the adequacy of its inspectorial activities as it had not established benchmarks for the number of workplaces to be inspected to address workplace risks within targeted industries. Accordingly, the justification for the number of workplace visits and inspectorial staff could not be established.

3.3.15 Information relating to workplace health and safety was provided by the Authority to the targeted industries with the highest incidence of workplace injuries, employer and employee representative bodies, and upon request to other parties. In order that a system that places responsibility on employers for workplace health and safety can operate effectively and that the full benefits of the Authority's activities are realised, the Authority needs to ensure that material which provides guidance on workplace health and safety is made available to all employers.

3.3.16 Finally, given that the Authority and the Victorian WorkCover Authority have a common objective to prevent injury and disease in the workplace, the integration of the 2 authorities may be worthy of consideration.

□ RESPONSE provided by Secretary, Department of Business and Employment

Audit appears to have made a very narrow interpretation of roles, responsibilities, recent strategies and current developments within the occupational health and safety administration.

The legislative framework for occupational health and safety in Victoria consists of a series of Acts, associated Regulations and Codes. While the Occupational Health and Safety Act sets an appropriate general framework, various specific Acts and Regulations are also administered.

A very extensive program of review of legislation is underway which is expected to be completed in 1994. This program is designed to remove a series of very prescriptive requirements and replace these with nationally agreed standards or safety outcomes to be achieved. The approach is designed to leave employers, and others in control of workplaces, equipment and hazards, with the responsibility and flexibility to select ways and means of achieving those outcomes and standards which best suit their own operations.

While it is essential that required outcomes are widely understood and available, it is not appropriate for a government authority to be perceived as the prime source of advice on means. Such an approach could be interpreted as a return to the prescriptive regulations which the current reforms are designed to avoid.

A major review of the Authority is currently being conducted by external consultants to recommend organisational arrangements, strategies and procedures which best support the revised regulatory framework.

Strategic approach to workplace injury prevention

3.3.17 The key aim of the Authority's activities is to reduce the incidence and severity of work-related injury and disease. To assist in the achievement of this aim, the Authority developed a workplace injury prevention strategy which provides for:

- development of policies and standards relating to workplace environments for distribution to employers and employees;
- distribution of information to employers and employees;
- implementation of workplace inspections and workplace risk assessments;
- monitoring by the Authority of the delivery of community and industry education programs by employer and employee representative bodies; and
- provision of training to employee representatives.

3.3.18 In implementing the strategy, the Authority targets industries with the highest incidence of workplace injuries. For the purpose of targeting emerging workplace risks, the Authority analyses data relating to overseas trends in workplace injuries, community concerns, new and developing industries, and outcomes of previous inspections and investigations of workplaces. In addition, the Authority undertakes inspections of specified equipment required by legislation and investigations of accidents and incidents resulting in serious injury or death.

3.3.19 In 1989, the Authority developed a model which uses statistics derived from the Victorian WorkCover Authority's workers' compensation claims database to assist in identifying those industries with a high incidence of workplace injuries. The statistics obtained include the number and cost of WorkCover claims and the total employee remuneration for each industry. Using this model, the Authority identifies on an annual basis, the *top 20* worst performing industries to assist in targeting its workplace injury prevention activities.

3.3.20 An audit review of the model found that while it may have achieved the objective set by the Authority of identifying the *top 20* worst performing industries, its effectiveness as a targeting device was questionable. The basis on which the model was formulated had the following shortcomings:

- certain key inherent risks were not considered, including the labour or capital intensity of the industry, location, activities undertaken by the industry, conditions under which employees operate, types of machinery or plant involved, injuries or disease linked with the industry, commitment of employers and employees to occupational health and safety, and skill levels possessed by the work force;
- statistics obtained did not include certain injuries and illnesses such as those resulting in less than 10 days absence from work and unsuccessful WorkCover claims, and those relating to the self-employed and people working on a voluntary basis;
- industries whose claims experience had deteriorated over a period of time did not receive attention until they were ranked within the *top 20*;
- an industry's ranking could improve, even though its claims experience remained stable, as a result of another industry's claims experience deteriorating; and
- as one of the criteria used to determine industry rankings is the average employee remuneration cost per claim, industries with the same claims experience but with different remuneration levels could be ranked differently in that based on this criteria those industries with a lower average remuneration cost per claim attract higher rankings.

3.3.21 Given that the model adopted for the targeting of the Authority's prevention activities was based on historical injury and cost data, and ignored adverse trends and various inherent risks, it resulted in a reactive approach to injury prevention by the Authority. In audit opinion, there is considerable scope to enhance the Authority's effectiveness through the adoption of a proactive approach to injury prevention which also seeks to identify and target industries with significant risks in workplace health and safety.

3.3.22 Notwithstanding the above shortcomings, it provided a structured means of identifying industries with the highest incidence of workplace injury. However, the review found that only 12 per cent of the Authority's workplace inspection activity was targeted using this model. The balance of the Authority's workplace inspection activity was not planned in the context of a structured risk-based targeting framework based on an objective assessment of all risks. Accordingly, the Authority could not be assured that its targeting of industries and activities was strategically focused to enable achievement of the Authority's objectives in the most efficient and effective manner.

□ RESPONSE provided by Secretary, Department of Business and Employment

Prevention Strategy

The multi-faceted strategy presently in place and described in Business Plans and Annual Reports since 1990, is aimed at reducing workplace injuries and disease and increasing compliance with regulations and standards on workplace health and safety. The major focus of the strategy is on high risk industries, establishments, hazards, injury/disease types, and systems of work which are specifically targeted for the Authority's programs. A range of activities may be implemented to achieve prevention objectives in an identified target area, including compliance and enforcement programs; community/industry education; training and information provision; and policy and standards development.

The Authority's OHS Steering Committee, comprising the most senior managers of the organisation, oversees the strategy. It meets monthly to consider strategic issues and ensure that available field, technical, advisory and support resources are directed toward priority areas. This approach acknowledges the need to continuously review prevention strategies.

The Authority's field activity, as advised to audit, consists of 3 components:

- (i) reactive programs (which includes investigation of accidents and incidents, and response to specified events identified in the Occupational Health and Safety Act 1985 and associated legislation);*
- (ii) statutory functions (which includes mandatory inspection of specified plant and equipment, and workplace visits associated with the administration of Acts and Regulations related to plant, equipment and dangerous goods); and*
- (iii) targeted programs and projects (which includes discretionary targeting of workplaces on specific industry, hazard, or client-based issues).*

The Authority acknowledges that in Australia, there is a need for more accurate information on workplace hazards, as well as improved statistics on work-related injuries and disease on which to base public policy decisions regarding the best possible measures to improve health and safety performance.

However, audit's contention that only 12 per cent of the Authority's workplace inspection activity is planned within a strategic risk-based framework is wrong. Audit was provided with information by the Authority which shows that it makes extensive use of information related to hazards such as plant, dangerous goods and noise in the planning and development of field activity. Field activity is also developed on the basis of accident and incident investigations, interstate and overseas experience and the local knowledge of field operatives.

Targeting Model

The claims-based targeting model used by the Authority as a planning aid is not intended, nor could it ever be, a comprehensive risk-based targeting tool. The model is based on historical incidence of injuries, as advocated by audit in paragraph 3.3.19 of this Report, and explicitly accounts for adverse trends in claim performance. While there may be a number of tools which could be considered, the Authority believes that the existing model and its use of a considerable range of compensation data is among the most comprehensive and sophisticated available. Victoria is one of the few jurisdictions in the world where detailed information about the location of workplaces and their accident histories is available to guide prevention activities. The approach advocated by audit is one which has not been adopted elsewhere in Australia or overseas. The Authority is not aware of any evidence that this approach would achieve the assumed benefits.

The targeting model is, and will continue to be, revised and refined to account for changes in the WorkCover system and changes to legislation which affects the current reporting of workplace accidents and hazards.

Communication of performance criteria and other information

3.3.23 Under a system that places responsibility on employers for workplace health and safety, all employers must be fully aware of their responsibilities to enable the most effective outcome to be achieved. In this regard, the Authority is responsible for the development of codes of practice relating to the workplace generally and specific codes for high risk activities. In addition, the Authority has sought to foster an awareness of its activities and the responsibilities of employers and employees for workplace health and safety through the production and distribution of various publications, targeted community education activities, workplace visits and broad awareness campaigns through the print and electronic media.

3.3.24 As the codes of practice were only available to employers **on request** and had to be purchased, the process did not ensure that all employers operating in industries with a high incidence of injuries were informed of desirable health and safety standards. Accordingly, **all employers were not in a position to effectively identify health and safety problems within their workplaces and take remedial action.**

3.3.25 Other publications and education programs are provided by the Authority to high risk industries identified by the prevention model, employer and employee representative bodies, and upon request to other parties. In relation to these, audit found that:

- The Authority's major publication which is produced quarterly is only distributed to around 5 per cent of the 185 000 registered employers within the State;
- While the Authority distributed publications to various employer and employee representative bodies, it had not determined to what extent such information had been passed on to employers and employees;
- The Authority did not maintain information on the key workplace activities of individual employers to enable effective targeting of the distribution of publications; and
- A promotion entitled *Workplace Health and Safety Week* was held for the first time in 1993 with the aim of increasing awareness of workplace health and safety issues. While the Authority proclaimed the promotion to have been a success, this assertion was not supported by an adequate performance assessment.

3.3.26 In 1989 and 1992, consultants engaged by the Authority conducted surveys to establish whether employers and senior management were generally aware of health and safety issues. Based upon the results of these surveys, the Authority considered that employers were generally aware of workplace health and safety issues. However, an analysis of the surveys by audit disclosed that they did not cover a representative sample of all employers, and that the sample sizes were acknowledged by the consultants conducting the surveys to be inadequate. Accordingly, audit considered that the results of the surveys were inconclusive.

3.3.27 **Given the need for all employers to be aware of their responsibilities for establishing and maintaining a safe workplace, action should be taken to broaden the distribution of information that impacts on all employers and to target the distribution of industry specific publications.** For this purpose, the Authority should utilise data available from the Victorian WorkCover Authority relating to individual employers, including details on key workplace activities. Furthermore, in order to better measure the level of employer and employee awareness of workplace health and safety issues, future surveys need to be soundly based.

□ RESPONSE provided by Secretary, Department of Business and Employment

Audit's presumption that sole responsibility to supply information to all employers rests with the Authority is contradictory with the performance-based principles of the Occupational Health and Safety Act 1985, where the onus is on the employer to discharge their "duty of care", including obtaining information from a range of alternative sources in order to exercise flexibility in how they meet their duties. The Authority's advisory program actively encourages all employers to seek assistance in obtaining information. In line with the legislative framework, it seeks also to inform employees, OHS professionals and the public on OHS matters.

The Authority is not aware of any evidence to support audit's assertion that distribution of written information to all employers will in itself substantially assist in the establishment and maintenance of safe workplaces. It would have been useful for audit to indicate where such an approach has been used successfully in comparable circumstances.

As indicated, the Authority has access to significant amounts of information on key workplace activities of individual employers and is able to tailor its range of publications to suit the varied needs of its workplace-based and community clients. It is not aware of additional data audit believes is held on the WorkCover database.

The Authority has led Australia in the development of OHS awareness raising campaigns, specific hazard information campaigns and the provision of high quality advisory materials. Workplace Health and Safety Week was acknowledged by involved employers and industry groups as a most innovative and valuable event on the OHS calendar. Audit has overlooked the fact that the Authority has conducted several major electronic and print media campaigns to raise awareness of OHS and distributes approximately 1 million publications a year to employers, employees, industry bodies, OHS consultants, and the general community through its field staff, information network and other distribution agents.

The Authority considers audit's comments to both underestimate the breadth of the Authority's information and advisory program and to misunderstand the role of codes of practice. Codes of practice are statutory instruments developed to support Acts and Regulations and are available, like Acts and Regulations, through Information Victoria.

The Authority believes the current arrangements have proved satisfactory in providing the Authority's diverse client-base significant access to relevant information. New approaches are constantly considered to address these needs and are an integral part of the current regulatory reform process.

Workplace inspections and penalties

3.3.28 As indicated previously, audit considers that any system that places responsibility on employers for workplace health and safety should also be subject to a program of risk-based work inspections and the imposition of appropriate penalties for non-compliance with established workplace health and safety requirements.

3.3.29 The various occupational health and safety legislation, administered by the Authority, provides for the appointment of inspectors to undertake:

- inspections or audits of workplaces to assess employer compliance with the legislative requirements;
- targeted inspections of hazardous workplaces;
- inspections of certain types of plant such as boiler and pressure vessels, and lifts and cranes; and
- investigations into accidents and incidents which bring into question the safety of the workplace environment.

3.3.30 The legislation also provides for the issue of directives requiring employers to rectify problems identified by inspectors relating to workplace environments and the pursuit of prosecutions through the court system if the identified problems are not rectified.

Inspections

3.3.31 The Authority engages 156 staff to undertake inspections of workplaces and specified equipment, and investigate accidents and incidents as required under relevant legislation. During 1992-93, the Authority advised that it conducted 21 100 inspections of workplaces, 24 300 inspections of specified equipment and 12 000 investigations of accidents and incidents.

Workplace inspections

3.3.32 Workplace inspections are focused upon targeted industries and activities, and workplaces containing equipment that require regular inspections in accordance with legislative requirements. The Authority is also required to undertake investigations of accidents and incidents which bring into question the safety of the workplace. The inspection program relating to the targeted industries and activities aims to assist in ensuring a safe workplace environment. However, as previously indicated, the program was deficient as the targeting of a significant proportion of the Authority's activities was not based upon a structured risk-based planning framework.

3.3.33 As part of workplace visits, the Authority had established a risk management program to assist employers to manage their workplace health and safety more effectively by assessing the comprehensiveness of procedures established by employers for injury prevention, claims management, and employee rehabilitation and return to work programs. Assessments under that program identified any action needed by employers to meet standard performance criteria in relation to workplace health and safety. During 1992-93, only 2.7 per cent (1991-92, 1.5 per cent) of establishments with work-related injury claims had an assessment performed under that program.

3.3.34 In early 1994, the program was augmented by the Safety Management Achievement Program, known as *SafetyMAP*. The new program provides for the issue of guidelines to participating employers to facilitate self-assessment by these employers of their existing systems of workplace health and safety against the guidelines and workplace audits by the Authority where requested by the employer.

3.3.35 Audit was advised that employer involvement in the new program is voluntary. The Authority estimates that between 20 000 and 70 000 employers will participate in the self-assessment phase of the program and that 6 000 employers will participate in all its elements. Based upon these estimates and the number of registered establishments on the WorkCover database (185 000 employers at 30 June 1993), only 3 per cent will be subjected to audit by the Authority.

3.3.36 In order to ensure that the full benefits of workplace risk assessments are realised, it is important that the Authority ensures that appropriate workplace safety guidelines issued under the Safety Management Achievement Program are made available to all employers to enable self-assessments to be undertaken, and audits conducted by the Authority against those guidelines are targeted to employers on a sound risk-based approach.

□ RESPONSE provided by Secretary, Department of Business and Employment

Audit was advised by the Authority that during 1992-93 the Authority conducted approximately 21 100 targeted workplace visits, 24 300 statutory workplace visits and 12 000 reactive visits. The nature of this field activity and the manner in which the Authority directs this activity within a planned framework is as described in the Management Response provided after paragraph 3.3.22 of this Report.

The Authority has advised audit that both the top 20 program and the previous Risk Management program account for only part of the Authority's strategic intervention effort. In both cases the number of establishments visited is not indicative of the percentage of employers covered and the percentage of total claims accounted for by these organisations. The 4 per cent of total field activity targeted towards workplaces in the top 20 industries provided coverage of 50 per cent of the workforce and 56 per cent of claims reported in those industries.

The Authority advises that the Safety Management Achievement Program is available to all employers. The Authority has advised audit that the SafetyMAP program is a management systems guide and considered to be less appropriate to smaller employers and its participation rate estimates are based on this fact.

Specified equipment inspections

3.3.37 Under the *Boilers and Pressure Vessels Act 1970*, inspections are required of high risk boiler and pressure vessels at intervals of between one and 10 years, depending on the type of vessel, while under the *Lifts and Cranes Act 1967* specified lifts are required to be inspected from *time-to-time*.

3.3.38 In relation to higher-risk boiler and pressure vessels, audit found that at 1 March 1994, 19 500 (60 per cent) of the 32 500 vessels had not been inspected within the intervals specified under the legislation. Of the inspections outstanding, 17 940 (92 per cent) were overdue for up to 2 intervals of inspection. In relation to lifts, the Authority endeavours to make annual inspections. However, based on the level of inspections performed during the 6 month period ended 31 December 1993, it would take the Authority 5 years to inspect all operational lifts.

3.3.39 Audit was advised that, effective from 1 July 1994, it is intended that the existing legislation relating to equipment such as boiler and pressure vessels and lifts and cranes will be replaced by the Occupational Health and Safety (Plant Safety) Regulations. The Regulations will require assessment by *competent persons*, which may include equipment owners, rather than mandatory inspections by the Authority as is currently the case. **For the new arrangements to be effective, random inspections, determined using a risk-based approach, should be considered by the Authority.**

□ RESPONSE provided by Secretary, Department of Business and Employment

Under the Boilers and Pressure Vessels Act, inspections are required to be carried out on registered boilers and pressure vessels at intervals of between one and 10 years.

The Authority agrees with audit on the need for a risk-based approach. Such an approach is currently used to plan inspections for boilers and pressure vessels. A similar form of targeting to guide audits of plant will be used when the new plant regulations are introduced.

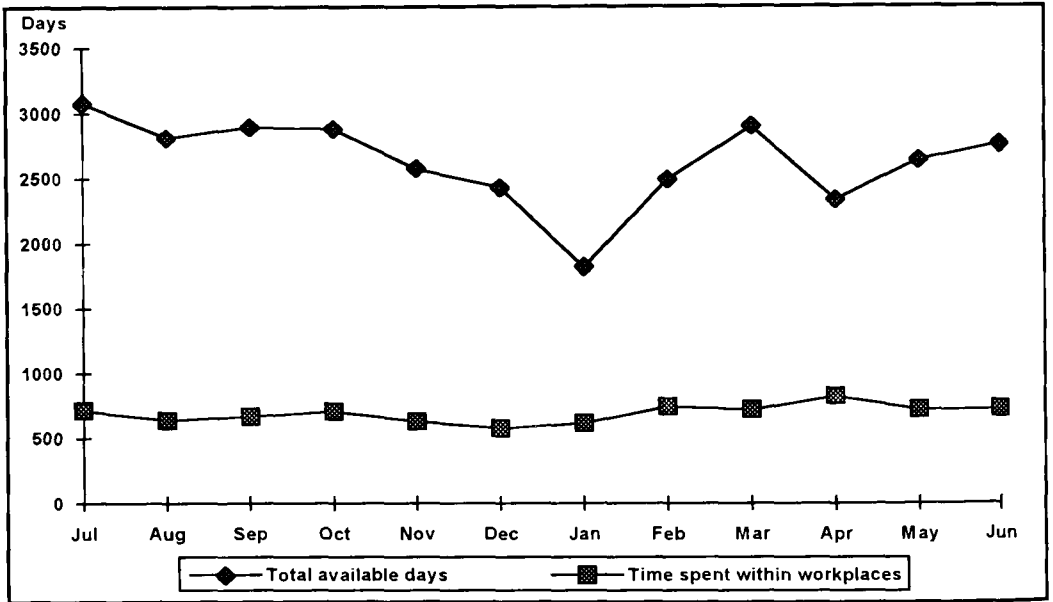
It should also be noted that the Authority recently took action to significantly decrease the number of boilers and pressure vessels required to be registered, enabling it to concentrate more closely on priority areas.

Utilisation of inspectorial staff

3.3.40 The duties of inspectorial staff not only include undertaking workplace visits and inspections of specified equipment but also administrative tasks such as report preparation related to such inspections, preparation for and attendance at court and participation in professional development activities.

3.3.41 A review of the activities of these staff revealed that during 1992-93, the time spent within workplaces only accounted for 26 per cent of the total available days. Chart 3.3B highlights this situation.

CHART 3.3B
TIME UTILISATION BY INSPECTORIAL STAFF WITHIN WORKPLACES, 1992-93
(Day equivalents)



3.3.42 The Authority's computerised time recording system accounts for time spent by inspectors at workplaces but did not record time spent on other activities. Accordingly, the Authority was unable to effectively assess the utilisation of these human resources. Furthermore, while 21 100 workplace inspections were undertaken in 1992-93, **in the absence of an established benchmark, the Authority was not in a position to effectively assess whether the number of inspections undertaken was adequate to address the workplace risks within the targeted industries. Accordingly, audit could not ascertain whether sufficient workplace visits were undertaken or whether the current inspectorial work force was in excess of requirements.**

□ **RESPONSE** provided by Secretary, Department of Business and Employment

As reported in the Department of Business and Employment's 1992-93 Annual Report, 58 746 workplace visits were conducted in that year.

The graphical representation made by audit compares raw information on available staff days with actual hours of on-site inspection converted to a 7.6 hour day equivalent. This representation ignores such direct elements as travel time for staff distributed across the State and the full range of duties carried out by the Authority, as outlined above.

Audit was provided with information showing the breakdown of time for inspectorial staff. Data was provided on the time spent on field duties (60 per cent), time spent on internal training (5 per cent) and time spent in field support duties (35 per cent). The latter covers office-based duties including report writing, telephone inquiries, court attendance and meetings. This profile is similar to interstate and international comparisons. International Labour Organisation surveys of European inspectorates found the norm for field allocation of inspectors as 3 days per week (60 per cent).

Consequently audit's assertion that the Authority does not keep records on non-field activities is not accepted. The Authority also rejects any inference that the level of workplace inspection time is somehow deficient in relation to some unspecified benchmark.

The time spent in workplaces is recorded on the Authority's SafetyNet system, an acknowledged world leader in inspection recording. Recently, travel time has been incorporated to give a more complete picture of field staff time allocation. The Authority agrees that analysis of time usage is an important part of the planning process and will continue to review and upgrade systems where a benefit is clear and cost effective.

On the issue of allocation of resources to address workplace risks, audit was provided with extensive information on the Authority's planning process. The number of inspections is not used by the Authority as a sole measure of effectiveness in addressing risks. Inspection may be one element of a response to targeted risks that also includes information, awareness and advisory activities.

Finally, the Authority notes that the level of inspectorial staff is defined by a number of factors including State-wide coverage, response to reactive workload, servicing of statutory requirements and targeted activity.

Penalties

3.3.43 Penalties provide an important incentive to ensure a safe workplace is maintained. In 1990, the former Department of Labour endorsed a policy which stated that "... the threat of criminal prosecution is a key element in the Occupational Health and Safety Authority's strategy for securing compliance with standards outlined in the Occupational Health and Safety Act 1985 and its attendant regulations. Prosecution is also considered important as a deterrent in relation to future contraventions". The policy also stated that the Authority would "... consider initiating proceedings under the Crimes Act 1958 where a work-related death or serious injury has occurred and where there is evidence of gross negligence by a body corporate or person in the workplace". This policy was endorsed by the Authority in 1993.

3.3.44 Under the Occupational Health and Safety Act, penalties were substantially increased in 1990 to encourage employers to maintain a safe workplace. Persons found guilty under the legislation of offences for which penalties are expressly provided, are liable for a maximum penalty of \$250 000 in relation to companies and \$50 000 for individuals, or up to 5 years jail, or both. Other offences for which no penalties are expressly provided, attract fines to a maximum of \$40 000 in relation to companies and \$10 000 for individuals.

3.3.45 Audit found that there is a disparity in the level of penalties provided under the Act, in that a company or person found guilty of intimidating a workplace inspector can be fined a maximum of \$250 000 or \$50 000, respectively. However, in cases where a company or individual is negligent in providing a safe workplace, the Act only provides for fines for each offence of a maximum of \$40 000 and \$10 000, respectively.

3.3.46 During 1992-93, fines imposed by Magistrates' Courts on average equated to 28 per cent of the maximum penalties prescribed by the legislation or \$7 500.

3.3.47 According to the Authority, the County Court generally imposed higher levels of fines than Magistrates' Courts. However, as the County Court has more stringent rules of evidence and generally involve significant delays in hearing the action, cases are generally not taken to the County Court. Since 1987, there have been only 4 matters heard in that Court with 6 cases currently pending trial following committal proceedings.

□ RESPONSE provided by Secretary, Department of Business and Employment

The Authority advises that the disparity of penalties available is due to the decision of the then Attorney-General's Department to not accept maximum penalties higher than \$40 000 for general offences (i.e not specifically defined and which cover the field of serious to trivial/technical breaches).

In relation to offences attracting the \$40 000 maximum, the Authority does not prosecute for the death or injury of any person. Breaches identified during the course of an investigation, which may be related to the death or injury of a person, form the basis of all prosecutions under the OHS Act. There may be several offences in any one case that lifts the maximum available by \$40 000 for each offence charged per incident.

Where a death has occurred, a charge for manslaughter under the Crimes Act may be laid in addition to OHS Act charges. A manslaughter charge attracts up to \$180 000 penalty or imprisonment up to 15 years.

Relationship between the Authority and the Victorian WorkCover Authority

3.3.48 As previously mentioned, the Authority is responsible for assisting in the maintenance of safe workplaces, while the Victorian WorkCover Authority has responsibility for administering the State's workers' compensation insurance scheme. **The roles of the 2 authorities are complementary in that they have a common objective to prevent injury in the workplace.**

3.3.49 Due to the close relationship between workplace health and safety and workers' compensation, there are strong arguments for these functions to be administered by one entity.

3.3.50 A review of workers' compensation arrangements within Australia undertaken by the Industry Commission in 1993, found that the integration within one entity of regulatory responsibility for injury prevention and workers' compensation offers the following benefits:

- employers and employees are provided with effective, integrated service delivery;
- prevention efforts are better targeted in respect of areas not adequately addressed by workers' compensation;
- the overall cost-effectiveness of injury prevention, rehabilitation and workers' compensation is optimised;
- more comprehensive injury statistics and research into occupational health and safety issues are able to be developed;

- overall accountability for occupational health and safety and workers' compensation management is improved; and
- the cost of injury prevention is funded by industry, and not the taxpayer.

3.3.51 Given these benefits, consideration needs to be given to a comprehensive review to investigate the potential for integration of the activities of the Authority and the Victorian WorkCover Authority. Such a review should explore the advantages or merits of forming a single entity responsible for workplace injury prevention, compensation and employee rehabilitation within the State. In this context, such an arrangement already operates with the Transport Accident Commission having responsibility for the transport accident prevention, compensation and the related rehabilitation function.

3.3.52 The Industry Commission Report concluded that "... in some jurisdictions, co-operation between occupational health and safety and workers' compensation authorities is inadequate and that it is important that they work closely together, although a complete institutional merger may not be necessary". However, in New South Wales, the Northern Territory and the Commonwealth, the workplace health and safety and workers' compensation functions are jointly administered by one authority.

□ RESPONSE provided by Secretary, Department of Business and Employment

While the Authority acknowledges that prevention, compensation and rehabilitation functions are jointly administered by one authority in 3 Australian jurisdictions, it notes that they are separately administered in 4 jurisdictions and are under the same government department in 2 other jurisdictions.

The Authority notes that the Industry Commission was unable to judge, based on its view that necessary information was not available, as to whether complete integration between compensation, rehabilitation and prevention is necessary to achieve better OHS results, or whether functional integration and co-operation is sufficient. The Industry Commission also observed that in the United States and in Europe it was unusual for compensation systems to have a strong preventive focus.

The issues of complete or functional integration will be kept under review as part of the Government's extensive financial and management reform program.

Performance measures to assess overall effectiveness

3.3.53 Audit was advised that the key indicators utilised by the Authority to assess its overall effectiveness in achieving its objectives are the levels of workers' compensation claims and work-related fatalities.

3.3.54 Over the period 1985-86 to 1991-92, the number of workers' compensation claims reduced by over 30 per cent while between 1986 and 1992 the number of work-related fatalities per year remained relatively stable at around 40.

3.3.55 The level of workers' compensation claims is not only affected by the activities of the Authority, but also by other factors such as legislative changes, economic trends, employer and employee attitudes, level of workers' compensation premiums and activities of the Victorian WorkCover Authority. Therefore, the extent to which the activities of the Occupational Health and Safety Authority contributed to the reduction in compensation claims cannot be readily determined.

3.3.56 Accordingly, there is a need for the Authority to develop more specific indicators that will enable greater accuracy in the assessment of its performance in preventing workplace injuries.

□ *RESPONSE provided by Secretary, Department of Business and Employment*

The Authority agrees with audit's comment that the respective contributions to claims trends is difficult to allocate. This is a difficulty experienced by all comparable agencies. However, the Authority believes on the basis of its own evaluation of specific projects that evidence about factors leading to improved health and safety performance is available.

Because of difficulties in establishing end-point impact indicators, attention is given to intermediary indicators and the Authority uses a range of these in specific areas.

CONSTRUCTION INDUSTRY LONG SERVICE LEAVE BOARD

ADMINISTRATION OF THE FUND

3.3.57 The Construction Industry Long Service Leave Board, which trades under the name of *ColInvest*, was established in 1983 to administer the Construction Industry Long Service Leave Fund, which provides workers and sub-contractors engaged within the construction industry with a portable long service leave scheme. The objectives of the Board according to its *1992-93 Annual Report* are to "... *provide superior, equitable and highly cost-effective administration of the Victorian portable long service leave scheme for employers and employees; maximise the rate of return on the Fund while maintaining diversity of investment and a prudent level of risk exposure; and ensure compliance with the Construction Industry Long Service Leave Act 1983*". At 30 June 1993, long service leave contributions covered 77 200 workers and 2 200 sub-contractors.

3.3.58 Under the Act, all employers operating within the construction industry must register with the Board and contribute to the Fund, at rates determined by the Board based upon actuarial advice, to assist in meeting the cost of providing employees with long service leave benefits. Each construction worker is entitled to 13 weeks paid leave after 15 years of industry service and a pro-rata benefit after accumulating 10 years of service. Sub-contractors must also register with the Board, however, it is not compulsory for them to contribute to the Fund. Upon completion of a minimum of 10 years of service, sub-contractors are entitled to a refund of any contributions made plus interest earnings at a prescribed rate. The prescribed rate is required to be set at a minimum 75 per cent of the overall rate of return of the Board's investments.

3.3.59 The May 1990 and April 1991 Auditor-General's *Reports on Ministerial Portfolios* drew attention to the excessive accumulation of funds by the Board, which had occurred primarily due to high contribution rates levied on employers prior to 1989 and the Board's good investment performance between July 1989 and December 1990. In response to those Reports, the Board advised that it would continue to commission actuarial assessments every 2 years and that it would use such assessments to monitor the level of contributions, with the *longer-term objective to reduce the magnitude of accumulated funds to the lowest practical level.*

3.3.60 To enable a reduction in the level of accumulated funds the Board, in December 1990, lowered the employers' contribution rate from 1 per cent to 0.5 per cent of the gross amount paid to employees. Notwithstanding this action, the level of net assets still grew from \$67 million at June 1989 to \$144 million at 30 June 1993, with the Fund's assets more than double those required to meet its total liabilities.

3.3.61 It was against the above background that audit conducted a review during 1993-94 of the Board's operations to assess whether it managed the Construction Industry Long Service Leave Fund in an efficient and effective manner, and in accordance with the relevant legislative requirements.

OVERALL CONCLUSION

3.3.62 The audit review found that the Construction Industry Long Service Leave Fund had been managed efficiently and effectively, with adequate procedures and practices established to ensure the proper administration of the portable long service leave scheme, the optimisation of investment returns and compliance with the Board's governing legislation.

3.3.63 The Board's net assets which have steadily increased over the past 5 years to \$144 million at June 1993, were at variance with its stated aim in 1989 of reducing its surplus funds to a prudent long-term level. However, in recognition of the undesirable trend, the Board in December 1993 waived the requirement for employers to contribute to the Fund. In addition, the Board has proposed various legislative amendments which are currently under government consideration, to enable the application of its excess funds towards the benefit of the construction industry through the removal of certain restrictions relating to the expenditure and investment of funds, and the recognition of workers' service for benefit purposes.

Accumulation of surplus funds

3.3.64 As previously stated, long service leave benefits payable to employees have been financed from employer contributions and investment earnings generated by the Fund.

3.3.65 The Construction Industry Long Service Leave Fund is a defined benefit fund in that regardless of the level of contributions and investment returns generated, workers are entitled to receive specified benefits based upon their level of earnings and years of service. However, in the case of sub-contractors, benefit entitlements are dependent on the level of contributions and investment returns.

3.3.66 Although the Board has gradually reduced the employer contributions from the dual industry rates of 2.5 and 2.0 per cent which existed prior to December 1989 to zero in December 1993, the level of surplus funds increased by \$77 million or 115 per cent over the 5 year period ending in June 1993. Over the same period, the funding ratio, which represents the percentage of funds available to meet actuarially assessed long service leave liabilities, increased from 166 per cent to 230 per cent. This compares with a prudential targeted funding ratio of 130 per cent determined by the Board in May 1993, based upon actuarial advice.

3.3.67 A summary of the operating performance and financial position of the Fund over the 5 year period 1988-89 to 1992-93 is detailed in Table 3.3C.

TABLE 3.3C
OPERATING PERFORMANCE AND FINANCIAL POSITION OF THE FUND,
1988-89 TO 1992-93
(\$million)

<i>Item</i>	<i>1988-89</i>	<i>1989-90</i>	<i>1990-91</i>	<i>1991-92</i>	<i>1992-93</i>
Operating performance					
Income -					
Contributions	22.0	18.9	10.0	5.1	4.6
Investment income	14.2	27.0	27.8	38.3	31.0
Other income	0.5	0.7	0.6	0.3	0.4
	36.7	46.6	38.4	43.7	36.0
Expenditure -					
Benefits (a)	15.2	23.3	18.1	14.3	8.5
Investment costs	1.5	1.7	1.0	1.3	1.6
Administration costs	6.1	6.9	6.8	7.1	6.5
	22.8	31.9	25.9	22.7	16.6
Operating profit before abnormal items					
	13.9	14.7	12.5	21.0	19.4
Abnormal items (b)	(92.0)	-	9.3	-	8.9
Net profit (loss)	(78.1)	14.7	21.8	21.0	28.3
Financial position					
Assets -					
Investments	168	200	221	244	260
Other	4	4	3	3	3
	172	204	224	247	263
Liabilities -					
Accrued benefits	101	117	124	125	111
Other	4	5	6	6	8
	105	122	130	131	119
Net assets	67	82	94	116	144
Funding ratio (%)	166	170	176	193	230

(a) Represents the net increase in the provision for long service leave liabilities after allowing for benefit payments to workers.

(b) The amount of \$92 million relates to long service leave liabilities previously not recognised; \$9.3 million to prior year gains on investment properties; and the \$8.9 million to long service leave liabilities previously overstated.

Factors impacting on the funding level

3.3.68 The audit review identified 3 key factors which have contributed to the accumulation of surplus funds, namely the favourable investment returns generated by the Board, the high contribution rates levied on employers in past years, and constraints over the distribution of funds where minimum service requirements have not been attained by employees.

Investment returns

3.3.69 Over the 5 year period to June 1993, the investment returns achieved by the Board have compared favourably with the average returns generated by similar fund management organisations, such as major public sector superannuation schemes. Table 3.3D discloses the investment returns achieved by the Board over the past 5 years compared with the average returns generated by the major public sector superannuation schemes.

TABLE 3.3D
COMPARISON OF INVESTMENT RETURNS, 1988-89 TO 1992-93
 (per cent)

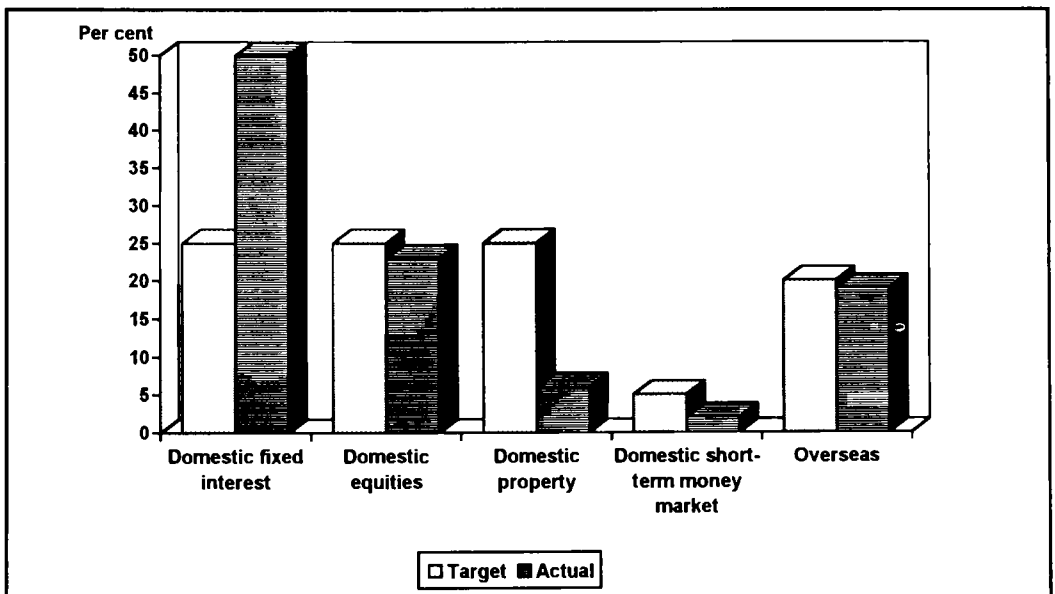
Year	Investment returns	
	Major public sector superannuation schemes	Construction Industry Long Service Leave Board
1988-89	10.8	11.0
1989-90	10.1	15.7
1990-91	8.1	12.2
1991-92	10.8	16.3
1992-93	11.3	13.7

3.3.70 The audit analysis disclosed that the Board achieved an average investment return of 13.8 per cent over this period compared with the average returns achieved by the major public sector superannuation schemes of 10.2 per cent. Audit recognises that due to the different cash flow requirements of the Fund compared with the superannuation schemes, the investment mix required differs which in turn impacts on the investment return.

3.3.71 The Board engaged 2 fund managers in 1988 and a further fund manager in 1991 to maximise its return from the investment portfolio. An investment strategy covering a 3 to 5 year period was established by the Board in 1991. This strategy which is subject to on-going review was based on the Board's cash flow requirements and desired risk profile for the portfolio. In addition, internal procedures have been established to facilitate regular evaluations of the performance of its fund managers.

3.3.72 The Board held investments totalling \$260 million at 30 June 1993. Chart 3.3E highlights the Board's investment mix at 30 June 1993 compared with its long-term target.

CHART 3.3E
FUNDS INVESTMENT MIX COMPARED WITH LONG-TERM TARGET, 30 JUNE 1993



3.3.73 The Board, as part of its investment portfolio strategy, has established a long-term target for overseas investments of 20 per cent. At 30 June 1993, 19 per cent of the Board's portfolio was in overseas investments, with 16 per cent in equities and 3 per cent in fixed interest securities. While the Board has established an overall target for its overseas investment holdings, which is consistent with the Department of the Treasury guidelines, targets have not been established relating to the investment mix. Accordingly, the Board is not in a strong position to manage its risks related to this component of the portfolio.

3.3.74 At 30 June 1993, 50 per cent of the Board's investment portfolio was held in domestic fixed interest securities, 23 per cent in domestic equities and 6 per cent in property. While the diversity of the portfolio, particularly in relation to domestic fixed interest and property investments, was not consistent with its long-term targets, the Board aims to progressively alter its investment mix with the view to achieving these targets.

3.3.75 At 28 February 1994, the Board held 42 per cent of its investment portfolio in domestic fixed interest securities, 28 per cent in domestic equities and 6 per cent in property compared with its targets of 25 per cent for each of these components.

3.3.76 Audit concluded that an effective framework had been established to ensure that investment returns were optimised within the risk parameters established by the Board. However, more specific parameters need to be established in relation to its overseas investment portfolio to more effectively manage the risk associated with this element of the portfolio.

□ RESPONSE provided by Chairman, Construction Industry Long Service Leave Board

As the Auditor-General has noted, the Board's investment strategy has resulted in a 35 per cent higher return than major public sector superannuation schemes and any further restrictive targets on fund managers may compromise the current flexibility and therefore reduce the risk return profile.

Contribution rates

3.3.77 As previously stated, the Board has progressively reduced contribution rates since December 1989 in order to reduce the excessive build-up of funds. Table 3.3F discloses the changes in contribution rates since that date.

TABLE 3.3F
CHANGES IN EMPLOYER CONTRIBUTION RATES
(per cent)

Date	Contribution rates	
	Building trades	Metals and electrical trades
Pre-December 1989 (a)	2.0	2.5
December 1989	1.0	1.0
December 1990	0.5	0.5
December 1993	0	0

(a) Operative from February 1988.

3.3.78 Despite the reduction in contribution rates, the level of surplus funds continued to escalate indicating that the contribution rates remained excessively high over this period.

3.3.79 The September 1993 actuarial assessment of the financial position of the Fund contained a recommendation that contribution rates should be set within the range of 0.5 per cent and zero and reviewed annually. Based upon conditions that existed at that time, **the Board's actuary estimated that a zero contribution rate could be sustained for the next 9 years.** In December 1993, the Board determined to waive employer contributions to the Fund.

Distribution of funds

3.3.80 Under the current legislative provisions, construction workers who leave the industry prior to accumulating a minimum of 10 years of service are not entitled to claim pro-rata benefits. Similarly, employers are not entitled to recoup contributions paid to the Fund in respect of workers who do not accumulate 10 years of service before leaving the industry.

3.3.81 The above restrictions are inconsistent with the entitlements that are currently available to members of long service leave schemes operating in New South Wales and the Australian Capital Territory where pro-rata benefits are available to workers who accumulate less than the minimum years of service.

3.3.82 Since the downturn in the building industry from November 1990, the number of workers who have left the industry prior to completing 10 years of service has escalated, which has contributed to the build-up of excess funds. Although the build-up of funds relating to those workers cannot be readily determined, in 1993 the Board's actuary estimated that only one in 3 will ultimately qualify for their long service leave entitlements.

3.3.83 **Given the current constraints over the distribution of funds where minimum service requirements have not been attained by employees, the Board will continue to accumulate surplus funds in relation to these employees.**

□ RESPONSE provided by Chairman, Construction Industry Long Service Leave Board

The Auditor-General's comparison with other long service leave schemes is noted, but the construction industry schemes in all States mirror their State's overall long service leave legislative framework for all workers. Changes to entitlements in the Victorian scheme would break this nexus.

It is important to stress that workers' entitlements are preserved for up to 9 years to allow for breaks in employment.

Initiatives to reduce surplus funds

3.3.84 In recognition of the need to arrest the continued increase in the level of surplus funds, the Board examined a range of options in September 1992 (most of which required legislative amendments) aimed at providing direct benefits to construction workers, employers and the construction industry in general. In January 1993, the Board received the Minister's agreement in principle to further pursue the proposed legislative changes.

3.3.85 Following consultation with the construction industry, the Board in November 1993 submitted to the Minister various proposed legislative amendments including:

- re-constitution of the Board as a company to facilitate removal of certain legislative restrictions on the expenditure of funds and allow greater flexibility in the provision of services to the construction industry;

- removal of existing legislative restrictions contained in the *Borrowing and Investment Powers Act 1987* on the Board's investment powers including the level of investments that can be undertaken within the construction industry; and
- minor amendments relating to the recognition of workers service for benefit purposes.

3.3.86 In March 1994, the Minister requested the Board to engage an external consultant to assist the Government in its deliberations on the above proposals.

Management practices adopted by the Board

3.3.87 In 1992, the Board prepared its first 3 year business plan which outlined various strategies and tasks aimed at ensuring that the Board's overall objectives were achieved. While that plan did not incorporate comprehensive performance indicators, such indicators were established in July 1993. Since that date, the Board has regularly measured its performance against these indicators.

3.3.88 The efficient and effective management of the Fund is largely dependent on the establishment of adequate internal processes by the Board to ensure that:

- all employees are registered and, prior to the waiving of employer contributions, that all employers contributed to the Fund in accordance with prescribed requirements;
- claims for long service leave benefits are bona-fide and promptly paid; and
- investment returns of the Fund are optimised.

3.3.89 Audit found that regular inspections were undertaken of records maintained by construction firms operating in the State to ensure that only bona-fide workers were registered and that employers, have in the past, paid the relevant contributions. In addition, field inspections of construction sites were adequately planned and undertaken by appropriately qualified officers, with the performance of those inspectors monitored. The inspections have been effective in detecting unregistered workers with 3 214 identified through this process during the past 2 years.

3.3.90 The Board's inspection process also provided a sound basis for the validation of employee service and remuneration details recorded on its information systems. These systems are used to determine benefit entitlements and ultimately the amounts payable to beneficiaries. All claims for the payment of benefits are checked to ensure that claimants are bona-fide.

3.3.91 Over the past 4 years, the cost of administering the Board's activities has marginally decreased in real terms from \$6.6 million in 1989-90 to \$6.5 million in 1992-93. Even though the volume of benefit claims processed by the Board increased by around 55 per cent over this period, staff numbers decreased from 109 to 90.

3.3.92 Consistent with the downturn in the building industry since November 1990, the active membership of the Fund has decreased by 27 900 to 79 400. Given the downward trend in membership, it is important that the Board continues to evaluate its administrative costs to ensure that resources employed are commensurate with its level of activity.

□ RESPONSE provided by Chairman, Construction Industry Long Service Leave Board

The Auditor-General is correct in saying that the volume of work and the quality of service has increased, while staff numbers have decreased. Since 30 June 1993, staff numbers have been further reduced by 10 to 80, and administrative costs reduced proportionally. Our administrative costs compare very favourably with other industry administrators.

VICTORIAN WORKCOVER AUTHORITY

FINANCIAL VIABILITY OF THE STATE'S WORKERS' COMPENSATION SCHEME

3.3.93 Previous Auditor-General's Reports to the Parliament have included comment on the financial viability of the State's former workers' compensation scheme, WorkCare, since its inception in 1985, and the key reforms introduced by the Government in 1989 to achieve a fully-funded position for the Scheme.

3.3.94 In brief, the financial performance of WorkCare during its first 3 years of operation was below that anticipated at its inception, necessitating government legislative intervention in 1989 which contributed to an improved financial position for the Scheme. Irrespective of this improvement, the Scheme's key financial objective of achieving a fully-funded position was not considered attainable, prompting further substantial government reform in December 1992. **This reform has now redressed the financial position of the new WorkCover Scheme, with the key financial objective of a fully-funded position within 3-5 years well on target. Due to the better than expected performance of WorkCover, the Minister has recently indicated that this target will be achieved within 2 years.**

3.3.95 The following paragraphs provide an overview of the financial position of the former WorkCare scheme from 1985 to its cessation in November 1992, and the current position of the successor Scheme, WorkCover.

The WorkCare Scheme

3.3.96 In September 1985, the Accident Compensation Act was enacted establishing the WorkCare workers' compensation scheme to replace the State's former multi-insurer workers' compensation system. The Act also provided for the establishment of the Accident Compensation Commission to administer the new Scheme.

3.3.97 A key financial objective of WorkCare, at its inception, was to generate sufficient employer levy and investment income over the first 10 years of its operations to cover all expenses paid and the outstanding claims liability at the end of that period. Notwithstanding this objective, at 30 June 1988, some 3 years into the Scheme's operation, it became evident that as actual compensation claims were substantially exceeding original estimates, and existing funding arrangements were unlikely to meet projected future liabilities, the key objective of having a fully-funded Scheme by 1995 was unlikely to be achieved without further changes to employer levy rates or benefits provided under the Scheme.

3.3.98 Specifically, at 30 June 1988 the funding level, which represents the ratio of available funds to meet outstanding claims liabilities, was only 25.6 per cent compared with a projected level of 74.1 per cent. Furthermore, contrary to government expectations, this funding level was in fact decreasing rather than increasing over time. The major contributing factors to this result included the increased number of claims incurred compared with projections (including the proportion and duration of long-term claims), insufficient employer levy rates and investment losses incurred as a result of the October 1987 stock market crash.

3.3.99 Continuing operating losses subsequent to 1987-88 and the consequent deterioration in the Scheme's financial position prompted government intervention late in 1989 in the form of legislative reforms. These reforms mainly involved the increasing of employer levy rates and the lowering of claim costs by reducing certain long-term entitlements and changing claims settlement procedures. With the introduction of this reform package, the former Government also replaced the previous key financial objective of achieving a fully-funded position for the Scheme within 10 years, with the following 3 key financial performance targets:

- generate an operating surplus each year so that the level of reserves are increased year-by-year;
- hold sufficient liquid reserves at the end of each year to meet the following year's cash outgoings; and
- ensure that unfunded claims liabilities at the end of any year are not greater than the projected revenue of the next succeeding 3 years.

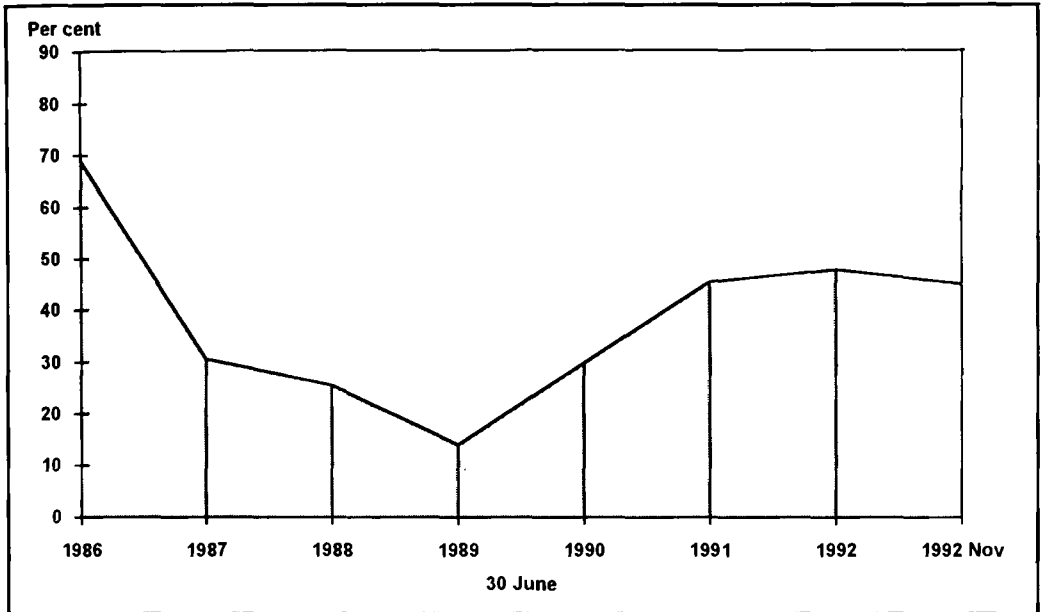
3.3.100 By 30 June 1992 it became evident that the 1989 reforms had been successful in arresting the Scheme's continuous and considerable financial losses, in that, over the preceding 3 years:

- the outstanding claims liability decreased from \$4.9 billion to \$3.6 billion;
- the Scheme's funding level increased from 14 per cent to 48 per cent;
- the number of open claims almost halved from 62 200 to 32 700;
- the revised financial performance targets were met over the period; and
- the accumulated deficit decreased from \$4.2 billion to \$1.9 billion.

3.3.101 Notwithstanding this improvement, the former Accident Compensation Commission considered that due, mainly, to the increase in the number of long-term beneficiaries and the associated increase in costs, the Scheme's financial position would not significantly improve in the future. In other words, the Commission considered it had exhausted all the 1989 reform provisions aimed at reducing the duration and average cost of claims and that the full extent of the financial improvement arising from these reforms had been achieved. It was also considered that the economic downturn could adversely affect the future level of levy income and that, unless further legislative changes were affected, the Scheme's funding level would remain below 60 per cent for the remainder of the decade as asset growth would, at best, only keep pace with the increasing outstanding liabilities.

3.3.102 Chart 3.3G shows the movement in the funding position of WorkCare over the life of the Scheme and, in particular, the impact of the 1989 reforms on its financial position.

CHART 3.3G
WORKCARE FUNDING RATIO, 1985-86 TO NOVEMBER 1992



3.3.103 The Commission's concerns regarding the financial position of WorkCare were addressed in November 1992 when further major reforms to workers compensation were announced by the Government, including the cessation of WorkCare and establishment of the new WorkCover Scheme. At that date, the WorkCare Scheme had an accumulated deficit of \$2 billion and a funding ratio of 45 per cent.

The WorkCover Scheme

3.3.104 The WorkCover Scheme was established on 1 December 1992 as part of a major legislative reform package embodied in the *Accident Compensation (WorkCover) Act 1992*. The **broad financial objectives of WorkCover**, which is administered by a new body, the Victorian WorkCover Authority, are to stabilise existing compensation costs and, within 3 to 5 years, attain a fully-funded position for the Scheme, while at the same time delivering workers' compensation in the most socially responsible manner. In order to achieve this outcome, the Government's legislative reforms were aimed at reducing the value and duration of benefits payable to injured workers. Claim eligibility criteria was also tightened by limiting compensable injuries to those where a worker's employment was a significant contributing factor, and excluding injuries incurred travelling to and from work and certain stress related injuries. In an effort to reduce future claim costs, existing long-term claimants were also offered lump-sum settlements.

3.3.105 The impact of these reforms was to significantly improve the financial position of WorkCover, in that, between the period 1 December 1992 and 30 June 1993:

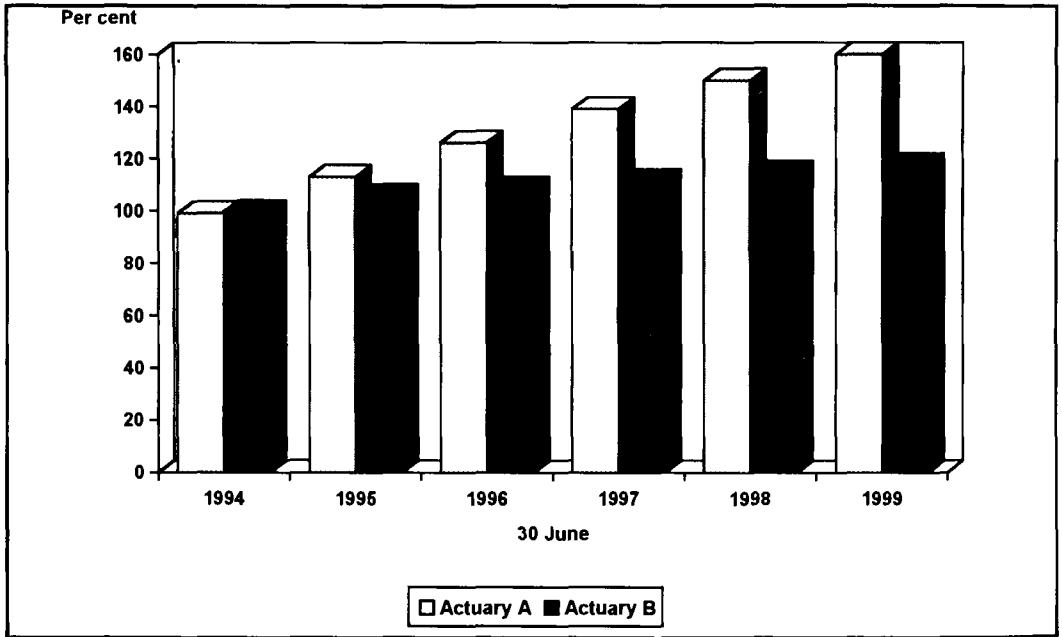
- outstanding claims liabilities decreased by 60 per cent, from \$3.8 billion to \$2.3 billion;
- the Scheme's funding ratio improved from 45.2 per cent to 82.4 per cent; and
- an operating surplus of \$1.7 billion was achieved, compared with a deficit of \$192 million for the final 5 months of WorkCare.

3.3.106 This substantial turnaround was mainly due to a 35 per cent reduction in the number of new claims, a 31 per cent reduction in the number of claimants receiving weekly benefits and a 20 per cent reduction in long-term claimants.

3.3.107 The financial performance of WorkCover has continued to improve during the 6 month period to 31 December 1993, with the funding ratio increasing to 92 per cent and the unaudited accumulated deficit reducing from \$396 million to \$223 million. These results compare favourably with the Authority's consulting actuary estimate for the same period of a funding ratio of 89 per cent and an accumulated deficit of \$240 million, and the Authority's objective of achieving a 90 per cent funding level by June 1994.

3.3.108 Based upon conditions that existed at June 1993, the Authority's 2 consulting actuaries anticipate that WorkCover will achieve full funding by 30 June 1994 and, 5 years hence the ratio is expected to be between 117 and 160 per cent. However, these forecasts do not allow for future changes to the Scheme's assets, which could not be reliably quantified, resulting from premium refunds and any reductions in the level of premiums. Chart 3.3H shows the 6 year actuarial forecasts of the Scheme's funding position.

CHART 3.3H
WORKCOVER ACTUARIAL PROJECTED FUNDING LEVELS, 1993-94 TO 1998-99



3.3.109 The Authority has recently established a prudential funding ratio of 120 to 130 per cent and is of the view that the Scheme's funding level will not exceed this target on a long-term basis.

3.3.110 Given the favourable actuarial forecasts of the future financial position of WorkCover, and the Scheme's performance to date, the Victorian WorkCover Authority is progressing well in achieving a fully-funded position for the Scheme.

□ **RESPONSE** provided by Chief Executive, Victorian WorkCover Authority

In relation to the audit report it is most important to note that the projected funding levels set out at Chart 3.3H of the audit report (based on the June 1993 valuations) make no allowance for premium refunds for 1993-94 which are likely to result in a reduction in available net assets (and hence affect the funding level); and assume future premium levels that may not eventuate (again, potentially affecting the level of available net assets and thus future funding levels).

It is also important to note the Board's policy is to establish, over time, a modest level of "free reserves" sufficient to smooth out any short-term cost and premium instability in the system. A target level of "free reserves" of approximately 20 per cent to 30 per cent of outstanding claims liabilities is envisaged.

In light of this policy and the way in which the premium system acts to ensure that cost changes are broadly reflected by premium changes it is not envisaged that the Scheme would ever exceed on a long-term basis more than about a 120 per cent to 130 per cent funding level.

The latest actuarial valuation accepted by the Board of Management of the Authority confirmed unfunded liabilities of \$192 million as at 31 December 1993.

**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

Report	Subject	Status at date of preparation of this Report
MATTERS RESOLVED OR ACTION COMMENCED		
VICTORIAN WORKCOVER AUTHORITY		
<i>Ministerial Portfolios, May 1993, pp. 56-7.</i>	The processes established to review the performance of authorised agents in managing WorkCover claims were not effective in assessing whether subjective assessments and decisions made by agents were soundly based.	The Authority has put in place revised processes for the review of the quality of insurer (formerly agents) decisions in relation to the processing of claims.
<i>Ministerial Portfolios, May 1993, pp. 58-9.</i>	The Authority needs to review its authorised agent performance scheme to ensure rewards offered to agents take account of the achievement of qualitative outcomes.	The performance scheme has been re-designed to include assessments of the quality of insurer performance.

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

Entity	Financial year ended	Reporting to Parliament	Financial statements signed by entity	Auditor-General's report signed
COMPLETED AUDITS				
Department of Business and Employment	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	21 Oct. 1993	21 Oct. 1993
INDUSTRY AND EMPLOYMENT				
Exhibition Trustees	31 Dec. 1993	31 March. <i>Annual Reporting Act 1983, s.9.</i>	24 Mar. 1994	28 Mar. 1994
Overseas Projects Corporation of Victoria Ltd	30 June 1993	No reporting requirements. Audit conducted at request of Treasurer and under the Corporations Law.	28 Sept. 1993	28 Sept. 1993
INDUSTRY SERVICES				
Construction Industry Long Service Leave Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	28 Sept. 1993	29 Sept. 1993
REGIONAL DEVELOPMENT				
Albury/Wodonga (Victoria) Corporation	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i> Extension granted to 31 Oct.	12 Oct. 1993	25 Oct. 1993
Geelong Regional Commission	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	27 Sept. 1993	29 Sept. 1993
" (a)	Period 1 July 1993 to 3 Dec. 1993	No date specified. <i>Annual Reporting Act 1983, s.9.</i>	3 Dec. 1993	30 Dec. 1993
Latrobe Regional Commission	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	14 Sept. 1993	17 Sept. 1993

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - <i>continued</i>				
SMALL BUSINESS				
Liquor Licensing Commission	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	22 Sept. 1993	24 Sept. 1993
Small Business Development Corporation	30 June 1993	" "	28 Sept. 1993	28 Sept. 1993
WORKCOVER				
Accident Compensation Commission (b)	Period 1 July 1992 to 30 Sept. 1992	31 Oct. <i>Accident Compensation Act 1985, s.38.</i>	30 Oct. 1992	11 Nov. 1992
" "	Period 1 July 1992 to 30 Nov. 1992	No date specified. <i>Accident Compensation Act 1985, s.38.</i>	3 Feb. 1993	11 Feb. 1993
Medical Panels (b)	Period 1 July 1992 to 30 Sept. 1992	31 Oct. <i>Accident Compensation Act 1985, s.72M.</i>	29 Oct. 1992	9 Nov. 1992
" "	Period 1 July 1992 to 30 Nov. 1992	No date specified. <i>Accident Compensation Act 1985, s.72M.</i>	22 Jan. 1993	29 Jan. 1993
Victorian Accident Rehabilitation Council (b)	Period 1 July 1992 to 30 Sept. 1992	31 Oct. <i>Accident Compensation Act 1985, s.177.</i>	31 Oct. 1992	10 Nov. 1992
" "	Period 1 July 1992 to 30 Nov. 1992	No date specified. <i>Accident Compensation Act 1985, s.177.</i>	22 Jan. 1993	29 Jan. 1993
Victorian WorkCover Authority	Period 1 Dec. 1992 to 31 Mar. 1993	30 April. <i>Accident Compensation Act 1985, s.38.</i>	7 May 1993	13 May 1993
" "	Period 1 Dec. 1992 to 30 June 1993	30 Sept. <i>Accident Compensation Act 1985, s.38.</i>	30 Sept. 1993	30 Sept. 1993

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - <i>continued</i>				
WorkCare Appeals Board (b)	Period 1 July 1992 to 30 Sept. 1992	31 Oct. <i>Accident Compensation Act 1985</i> , s.71Q	29 Oct. 1992	9 Nov. 1992
" "	Period 1 July 1992 to 30 Nov. 1992	No date specified. <i>Accident Compensation Act 1985</i> , s.71Q.	27 Jan. 1993	28 Jan. 1993

(a) The Commission was abolished on 3 December 1993 following repeal of the *Geelong Regional Commission Act 1977*.

(b) The functions of these entities were subsumed by the Victorian WorkCover Authority on 1 Dec. 1992.

Part 3.4

Conservation and Natural Resources

KEY FINDINGS

DEPARTMENT OF CONSERVATION AND NATURAL RESOURCES

Government Services Agreement For Water Management Services

- The Department has made positive progress towards achieving greater efficiency and effectiveness in the delivery, under contract, of water management services by the Rural Water Corporation.

Paras 3.4.4 to 3.4.14

MAJOR REFORM PROGRAM FOR THE WATER INDUSTRY

- The Government's reform program for the water industry extends far beyond the various reform initiatives taken by segments of the industry over recent years.

Paras 3.4.15 to 3.4.20

MELBOURNE WATER CORPORATION

Update on outsourcing of information technology services

- The Corporation has commenced action to remedy the shortcomings in its cost management procedures under its information technology outsourcing arrangements.

Paras 3.4.27 to 3.4.34

- The Corporation's recent strategic management initiatives have placed it in a position where it can maximise its benefits from the existing outsourcing partnership while, at the same time, more effectively control its future IT strategies.

Paras 3.4.35 to 3.4.39

Update on 1992 and 1993 sewer collapses

- Since the serious 1992 and 1993 sewer collapses, the Corporation has made significant progress in upgrading its strategic management of the sewer infrastructure.

Paras 3.4.40 to 3.4.44

KEY FINDINGS - *continued*

RURAL WATER CORPORATION

Aged condition of rural water supply infrastructure

- The State's rural water supply infrastructure is aged and substantial levels of expenditure on asset replacements and maintenance will be required in future years to upgrade its condition.
Paras 3.4.45 to 3.4.55
- The Northern Mallee pipeline project is aimed at overcoming serious water quality, wastage and environmental problems which have been experienced with the aged, open channel system within the Wimmera-Mallee region.
Paras 3.4.56 to 3.4.72
- Significant early benefits in the form of water savings and environmental flows have followed completion of the first stage of the pipeline project.
Paras 3.4.73 to 3.4.79
- The Corporation should take action to ensure it is presenting the strongest possible case for future government funding of remaining stages of the pipeline project.
Paras 3.4.80 to 3.4.87

Hydro-electric schemes at water storages

- The Corporation would benefit from a re-assessment of the adequacy of its overall approach to negotiations with private developers in respect of small hydro-electric schemes.
Paras 3.4.88 to 3.4.95

Outcome of negotiations with SECV on Eildon Reservoir Agreement

- Although the recently-agreed terms with the SECV relating to hydro-electric power at the Eildon Reservoir did not represent an optimum commercial result for the Corporation, it considers that it achieved a "best possible" outcome.
Para 3.4.96 to 3.4.100

ROYAL BOTANIC GARDENS BOARD

- Since the appointment of the Royal Botanic Gardens Board in July 1992, substantial progress has been made in meeting the challenges facing the Gardens, including a legacy of insufficient funding and overall development plans, a backlog of essential maintenance and the ageing of Flora. The Board needs to further build on these achievements in the future.
Paras 3.4.101 to 3.4.149

VICTORIAN INSTITUTE OF MARINE SCIENCES

- Contributing to a deterioration in financial viability of the Victorian Institute of Marine Sciences since 1991 was the excessive size of the Institute's Council and its failure to hold regular meetings to strategically direct and monitor operations.
Paras 3.4.161 to 3.4.168
- Despite the decline in the financial viability and liquidity of the Institute since 1991, little positive action was taken to address this situation until September 1993.
Paras 3.4.172 to 3.4.182

3.4.1 Two Ministers, namely the Minister for Conservation and Environment and the Minister for Natural Resources, have responsibility for operations within the Conservation and Natural Resources sector. These Ministers have collective responsibility for the Department of Conservation and Natural Resources.

3.4.2 Details of the specific ministerial responsibilities for public bodies within the Conservation and Natural Resources sector are listed below in Table 3.4A. These public bodies, together with the Department of Conservation and Natural Resources, are subject to audit by the Auditor-General.

**TABLE 3.4A
MINISTERIAL RESPONSIBILITIES WITHIN THE
CONSERVATION AND NATURAL RESOURCES SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Conservation and Environment	Bundoora Park Committee of Management Environment Protection Authority Mount Macedon Memorial Cross Committee of Management Olympic Park Management Penguin Reserve Committee of Management Port Bellarine Committee of Management Recycling and Resource Recovery Council Royal Botanic Gardens Board Shrine of Remembrance Trustees State Swimming Centre Committee of Management Victorian Conservation Trust Yarra Bend Park Trust Zoological Board of Victoria Zoological Board of Victoria Superannuation Fund
Natural Resources	Alpine Resorts Commission Melbourne Water Corporation Melbourne Water Corporation Employees' Superannuation Fund Non-metropolitan water authorities (115) Rural Water Corporation Victorian Institute of Marine Sciences Victorian Institute of Marine Sciences Superannuation Fund Victorian Plantations Corporation (a) Water Training Centre (b)

(a) Established July 1993.

(b) Established November 1993.

3.4.3 Comment on matters of significance arising from the audit of certain of the above entities is provided below.

DEPARTMENT OF CONSERVATION AND NATURAL RESOURCES

GOVERNMENT

SERVICES AGREEMENT FOR WATER MANAGEMENT SERVICES

3.4.4 For many years, predecessor bodies of the Rural Water Corporation carried out on behalf of the Government a range of water management services including drilling operations, salinity control and flood mitigation which were ancillary to their core function of providing water to users outside the metropolitan area. As these services were undertaken primarily for the purpose of benefiting the wider community, their costs were directly funded by the Government.

3.4.5 Under longstanding financial arrangements, the nature and extent of services to be performed were essentially determined by the Corporation's predecessor bodies and associated costs were automatically reimbursed from the Consolidated Fund without any form of overview or assessment from other areas of government.

3.4.6 As part of the major restructuring process associated with the formation of the Corporation from 1 July 1992 (summarised in the Auditor-General's *Report on Ministerial Portfolios, May 1993*), the Government determined that, in future years, the provision of services previously funded from the Consolidated Fund would be subject to specific contractual arrangements. The then Department of Water Resources (DWR) was assigned the responsibility to enter into these arrangements on behalf of the Government. DWR subsequently became part of the Department of Conservation and Natural Resources.

3.4.7 The inaugural agreement between the Department and the Corporation for government services was signed in January 1993 and covered the financial year ended 30 June 1993. The value of services to be provided by the Corporation under the contractual agreement totalled \$19.5 million. The agreement incorporated a description of tasks to be performed, specific performance standards to be achieved and the nature of documentary evidence required from the Corporation to support payments for services.

3.4.8 A summary of the Corporation's work program for 1992-93 is set out in Table 3.4B.

TABLE 3.4B
WORK PROGRAM FOR 1992-93 GOVERNMENT SERVICES
((\$million))

<i>Item</i>	<i>Amount</i>
Co-ordinated salinity control expenses	10.7
Resource management expenses	5.1
Drilling services associated with groundwater management	2.2
State works of water supply, salinity mitigations, sewer improvements, flood mitigations and other works	1.5
Total	19.5

3.4.9 An audit review of these initial contractual arrangements disclosed that:

- Clear strategic directions had not been developed by the Department to ensure services to be performed under the agreement were consistent with the Government's priorities. Basically, tasks to be performed for the year were determined by the Corporation;
- The Department did not monitor the services provided by the Corporation and, consequently, was not in a position to determine whether performance was in line with the required standards; and
- Documentation on functions undertaken which was provided by the Corporation fell short of the standard outlined in the agreement in that claims were not supported by a detailed explanation of work performed, a breakdown of costs according to the specified classifications and a progress report on work completed.

3.4.10 The Department recognised there were deficiencies in the management framework for the initial 1992-93 agreement and initiated action to strengthen the arrangements for 1993-94. In this regard, it formed a steering committee to oversee the development of the agreement with the aim of exercising greater control over formulation of the work program for the period. As a consequence of the steering committee's involvement in the process, the agreement for the second year was developed on the basis of projects agreed between the Department and the Corporation. In addition, several working groups comprising representatives from each agency were established with the responsibility of developing detailed proposals for approved projects and monitoring service delivery against performance targets.

3.4.11 The 1993-94 contractual agreement was signed in November 1993 and **provided for the delivery of services by the Corporation to the value of \$18 million, representing a 7.7 per cent decrease (\$1.5 million) from the previous year.** This decrease, which related to non-salinity projects, resulted from a more stringent analysis and prioritisation of work proposals by the newly formed working groups and steering committee. The proposals included in the final agreement were selected on the basis that they:

- provided an overall net benefit, including benefits of an economic, social and environmental nature, to the community; and either
- could not be funded on a user-pays basis; or
- were required to be provided under the agreement in line with government policy.

3.4.12 In discussions with audit, the Department advised that it intended to explore avenues during the formulation of the 1994-95 agreement, to further strengthen the strategic management framework for the periodic government services provided by the Corporation. It expects greater efficiency gains to be realised in that year and a closer nexus to exist between the various service activities and strategic policy objectives of the Government.

3.4.13 It can be seen that definite progress has been made by the Department towards achieving effective government involvement in the strategic direction and control of water management services provided on the Government's behalf by the Corporation.

3.4.14 As the Department proceeds further in its plans to achieve greater efficiency and effectiveness in the delivery of the services, it will need to consider the ramifications of the impending re-organisation of the Corporation into 5 regional rural water authorities and the feasibility of introducing competitive forces into the area via tendering arrangements.

□ **RESPONSE** provided by Secretary of the Department of Conservation and Natural Resources

The audit report has identified transitional problems with the creation of the Government Services Agreement. It also correctly identified that the deficiencies were known and are being corrected. The recommendations relating to the impending 5 regional rural water authorities and competitive tendering will be addressed by the Department.

MAJOR REFORM PROGRAM FOR THE WATER INDUSTRY

3.4.15 In October 1993, the Government announced a series of major reforms designed to improve the service and performance of the Victorian water industry.

3.4.16 In a wide-ranging reform statement entitled *Reforming Victoria's Water Industry: A Competitive Future*, the Government outlined the key ingredients of its reform program and how the program will impact on the water industry's 3 main segments, namely, the Melbourne Water Corporation in terms of the delivery of water, sewerage and drainage services within the metropolitan area, the Rural Water Corporation covering rural water services and the non-metropolitan urban water authorities which are responsible for urban water and wastewater services throughout the State. The details relating to Melbourne Water were refined in the Treasurer's *Economic Statement* of April 1994.

3.4.17 Some of the features of the Government's reform program in terms of its application to the 3 principal industry segments are summarised below:

Melbourne Water Corporation

- Clear separation of the Corporation's parks and waterways functions from its core business responsibilities of provision of water, sewerage and drainage services; and
- Introduction of competitive pressures through restructuring of Melbourne Water into 3 catchment-based water businesses and a headworks business comprising the dams, major water distribution systems, the major sewerage collection system and the treatment plants.

Rural Water Corporation

- Devolution of responsibility for headworks operations to the Corporation's 5 regional boards with the boards becoming separate autonomous authorities from mid-1994; and
- A detailed assessment of the State's irrigation assets.

Non-metropolitan urban water authorities

- Acceleration of amalgamation processes with an intention that amalgamated authorities will eventually be broadly-aligned with the State's water catchment areas; and
- A strong focus by authorities on the core business functions of urban water and wastewater services and on the adoption of commercial management principles.

3.4.18 The reform program also announced strategies for the development of water trading to govern transfers of water within the State and the establishment of working groups to formulate solutions to pressing health and environmental issues such as the quality of rural drinking water and effluent standards for waterways.

3.4.19 The Government has directed particular emphasis to ensuring that a sound framework is in place for the overview and implementation of its various reform strategies for the industry. Under the auspices of a special steering committee reporting to the Treasurer and the Minister, the Office of State-Owned Enterprises within the Department of the Treasury has prime responsibility for project management, with several significant tasks assigned to a newly-established Office of Water Reform within the Department of Conservation and Natural Resources.

3.4.20 A major industry-wide review process is currently underway within the State. Its boundaries extend far beyond the various reform initiatives taken by segments of the industry, e.g. Melbourne Water Corporation over recent years. There is little doubt that the review program will have far-reaching ramifications for the future structure and management of the water industry.

MELBOURNE WATER CORPORATION

UPDATE ON OUTSOURCING OF INFORMATION TECHNOLOGY SERVICES

3.4.21 The Auditor-General's *Report on Ministerial Portfolios, May 1993*, included comment on the results of an audit review of the engagement by the Corporation of a private company, Melbourne Information Technology Services Ltd (MITS), under a management buyout arrangement to be sole supplier of the Corporation's IT services over the 5 year period to October 1995.

3.4.22 The review found that substantial benefits had been achieved by the Corporation from the engagement, particularly in relation to the quality and timeliness of IT service delivery and recognition of its critical link with the pursuit of key business goals and satisfying customer needs.

3.4.23 However, audit found that the absence of competitive forces in the outsourcing arrangement and shortcomings in the Corporation's cost management worked clearly to the financial advantage of MITS. In addition, limited attention was directed to establishing commercial benchmarks against which fees paid to MITS for various services could be evaluated. Furthermore, the transfer to MITS of all significant IT expertise left the Corporation in a position of dependence on MITS for strategic and technical management advice.

3.4.24 The May 1993 Report also outlined the various lessons which could be learned from the Corporation's outsourcing experiences by the increasing number of public sector bodies contemplating or already pursuing placement of IT services with the private sector.

3.4.25 During the year, audit examined progress made by the Corporation to address the issues identified in the earlier review of the outsourcing process.

3.4.26 Audit concluded that the Corporation has commenced action to remedy the cost advantages which have been enjoyed by MITS under the outsourcing arrangements. Also, its recent strategic management initiatives have placed the Corporation in a position where it can maximise its benefits under the existing partnership with MITS while, at the same time, more effectively control its future IT strategies.

Fee setting process for facility management services

3.4.27 In the review of the Corporation's arrangements to outsource IT operations to MITS, audit found that the Corporation had been restricted from gaining maximum cost savings because much of the annual fee setting process with MITS was based on the Corporation's pre-October 1990 IT costs (subject to CPI variations and a minimum real reduction in costs of 5 per cent). These historical costs, which related to the operations of the Corporation's former IT Department, were based on a framework which was known by the parties to have been highly inefficient and of little relevance to the new arrangements.

3.4.28 With regard to facility management services, which cover the operation and support of mainframe computer systems, communications networks, telemetry and digital mapping, audit identified several features of the fee setting process which restricted the Corporation's capacity to fully minimise costs, including:

- specific information regarding costs incurred by MITS in delivering IT services to the Corporation not made available by MITS during annual fee negotiations;
- reimbursement to MITS of rental costs for accommodation not used by MITS to service the Corporation;
- application of a specified profit margin to the total pre-October 1990 cost basis and to other items included in the fee calculations such as rental, corporate overheads and depreciation; and
- inclusion of costs for corporate overheads and depreciation without review by the Corporation of the continued relevance of the amounts involved.

3.4.29 For 1993-94, the facility management services fee was calculated using the 1992-93 fee as a base, adjusted for agreed business cost variations and a 5 per cent cost reduction. Through a number of initiatives, including the detailed documentation of its communications network services, the Corporation acquired an improved knowledge of systems operations and maintained more accurate information in areas such as the use of telecommunications and associated costs, when compared with previous years. This enhanced position enabled the business cost variations sought by MITS to be minimised. In addition, the 1993-94 fee benefited from the compound effect of cost reductions of 5 per cent or more for 3 successive years. **As a result, the Corporation achieved a reduction of \$1.2 million in facility management services fees payable to MITS for 1993-94 compared with the 1992-93 level.**

3.4.30 Notwithstanding the more favourable outcome to the Corporation for 1993-94, the fee negotiation process and resultant fee structure for facility management services are still primarily predicated upon an inappropriate pre-October 1990 historical cost basis, which, together with the consequential impact of the other restrictive features previously identified by audit, has been the main source of financial advantage to MITS.

3.4.31 Audit has been advised by the Corporation that, from 1994-95 onwards, fees will be based on actual computer resource usages for individual services and systems, as detailed in service level agreements. Also, in negotiating future fees, the Corporation will draw on the experience of its newly-appointed Director of Business Systems and on external specialists.

Fee setting process for other cost areas

3.4.32 In addition to facility management services, the IT services provided by MITS under the outsourcing arrangement cover charged services (which include small equipment and software purchases and end-user computing services such as office automation and word processing) and information systems development (new IT systems and modification or replacement of existing systems). The 1993 audit review also identified factors which impinged on the Corporation's ability to fully minimise outsourcing costs in these 2 cost areas. These factors related to:

- excessive prices paid by the Corporation to MITS for smaller computer hardware and software items in comparison with standard government contract rates;
- inclusion within charges of factors such as depreciation on the Corporation's equipment which had no relevance to the outsourcing structure; and
- lack of commercial benchmarks for assessing rates charged by MITS for systems development activities.

3.4.33 It was pleasing to find that, in the 1993-94 outsourcing negotiations with MITS, the Corporation had substantially addressed these issues. The negotiated arrangements for the year provided for:

- the purchase of small computer hardware and software items utilising either bulk purchasing opportunities or standard government purchasing prices (representing cost reductions of 30 per cent in respect of standard software and 40 per cent in respect of personal computer items);
- a 25 per cent reduction in charges for end-user services; and
- MITS charge rates for systems development activities to be assessed against external competitive benchmarks, discounted to reflect the scale and non-competitiveness of the outsourcing environment.

3.4.34 Through these measures, the Corporation has strengthened its position in terms of enhancing the cost efficiency of IT services provided by MITS.

Strategic and technical management of outsourced IT services

3.4.35 The earlier audit review concluded that the transfer of all significant IT expertise to MITS left the Corporation in a position of strategic dependence on MITS, especially in relation to specialist technical knowledge of its key business systems. To overcome this significant strategic exposure, audit recommended that the Corporation:

- establish internal management control of technology strategy, the systems development process and quality assurance, complemented by independent professional IT advice; and
- implement an internal management development and training program covering major IT concepts, technologies, directions, business implications and its systems development methodology.

3.4.36 During 1993, the Corporation directed significant effort to the upgrading of its strategic and technical management capabilities for IT. The main feature of this effort has been the strengthening of its internal IT management capabilities through the appointment of an experienced IT professional to head its corporate business systems division. This division has commenced establishment of a strategic IT management framework which, when finalised, will be integrated into the Corporation's capital works management structure.

3.4.37 Features of the new framework include:

- a formalised business systems management process;
- an IT systems management manual;
- guidelines to managers for the preparation of business-oriented and benefit-justified IT system proposals; and
- procedural standards to facilitate project management of approved business systems projects.

3.4.38 The Corporation has advised that the new management framework will be integrated into all management training programs to ensure managers are competent to undertake IT management responsibilities. The corporate business systems division will provide quality assurance through participation in approval processes at various stages, utilising external technical specialist support as deemed necessary.

3.4.39 As a result of these actions, the Corporation has begun to address the important management lessons identified in the 1993 audit review and increase its capacity to assume effective management control of business applications planning, technology strategy and technical performance and quality.

□ RESPONSE provided by Managing Director, Melbourne Water

Throughout the duration of the outsourcing arrangements, Melbourne Water has continued to focus on the entire scope of benefits accruing and enhancements in IT services, not just cost aspects (although significant benefits have been realised in terms of cost). Melbourne Water had identified and commenced implementation of the necessary management processes to upgrade its strategic and technical management processes for IT prior to audit's recognition of these matters in 1993.

UPDATE ON 1992 AND 1993 SEWER COLLAPSES

3.4.40 The Auditor-General's *Report on Ministerial Portfolios, May 1993* referred to 3 significant sewer collapses which occurred in suburban streets of Melbourne within a period of 5 months during 1992 and early 1993. The Report described the emergency repair action required by the Corporation at an estimated cost of around \$13 million and outlined the long-term strategies developed by the Corporation, as a result of the collapses, to review the soundness of its strategic management of the sewer infrastructure.

3.4.41 At the date of preparation of this Report, repair work by the Corporation on one of the collapsed sewers was still in progress. The Corporation expects this work to be completed by May 1994 and that the final total cost of repairs to all 3 collapsed sewers, which encompassed additional works associated with rehabilitation of surrounding areas, will now be about \$21 million.

3.4.42 The key element of the Corporation's long-term response to the sewer collapses was the introduction of *Operation Sewer Safe*, a high priority program of sewer repairs and renewals aimed at identifying potential weak spots in the sewer system and minimising the possibility of untreated wastewater escaping to the environment.

3.4.43 The major actions taken by the Corporation under its *Operation Sewer Safe* initiative since the May 1993 Report have been:

- completion of preventative repair work at 2 main sewers, identified as high priority trouble spots, within suburbs of Melbourne at a total cost of \$2.4 million;
- implementation of a program for the routine inspection of the structural condition of sewers, with 530 kilometres of sewers programmed for inspection during 1994-95;
- completion of closed circuit television inspection of all brick sewers;
- establishment of an instant response team to identify and manage risk areas of the system;
- modification of selected sewer inspection openings to accommodate emergency bypass pumping facilities;
- introduction of radar and sonar inspection of critical sewers; and
- expansion of aggregate expenditure over the next 10 years from \$140 million to \$610 million under its sewer repair and renewal program in order to address structural and hydraulic weaknesses within the sewer system.

3.4.44 Since the serious 1992 and 1993 sewer collapses, the Corporation has made significant progress in upgrading its strategic management of the sewer infrastructure.

RURAL WATER CORPORATION

AGED CONDITION OF RURAL WATER SUPPLY INFRASTRUCTURE

3.4.45 The Rural Water Corporation is responsible for the supply of water for agricultural, urban and industrial uses outside the metropolitan area of Melbourne. It also has a major role, under a service contract with the Government, in other water management functions including flood protection, river management, drainage and salinity control. The supply of water by the Corporation to rural Victoria involves the operation and maintenance of an extensive network of irrigation, stock and domestic water supply systems consisting of a range of key assets including dams, weirs, channels, pipelines and drains.

3.4.46 Through its water reticulation infrastructure, the Corporation annually delivers:

- approximately 3 million megalitres of water to around 16 000 irrigators;
- urban water supplies to 143 rural cities and towns; and
- about 36 000 megalitres to some 6 000 farms throughout the Wimmera-Mallee region for stock and domestic purposes.

3.4.47 The value of water supply infrastructure assets owned by the Corporation was around \$2.4 billion at 30 June 1993. In addition, the Corporation manages assets with a value of approximately \$700 million on behalf of the Murray-Darling Basin Commission.

3.4.48 In recent years, 2 major studies have commented on the aged condition of the State's rural water supply infrastructure. The January 1992 report of a major Government review (the McDonald review), which led to the establishment of the Corporation from 1 July 1992, commented on the "run down" condition of rural water supply assets. The Industry Commission, in its July 1992 report on water resources and waste water disposal, referred to the "... *major maintenance backlog in Victoria's irrigation systems*". In a submission to the Industry Commission, the Corporation stated that it was "... *investing at least 30 per cent less than that required to keep all assets up to current service levels*".

3.4.49 The aged and deteriorating condition of the rural water reticulation infrastructure has been brought about primarily by progressive underspending by the Corporation's predecessor bodies on capital replacements and repairs and maintenance. These bodies were reliant on government funding for their capital works and maintenance programs. Annual government appropriations were generally insufficient to maintain water supply assets at a level required to meet service needs without wastage of significant quantities of water. Furthermore, past pricing practices placed minimal significance on "user-pays" principles and the need to achieve full cost recovery from consumers in the delivery of services. As a consequence, annual revenues barely covered direct operating costs.

3.4.50 The Corporation's recent experience with the Torrumbarry Weir, located on the Murray River near Echuca, provides an example of the consequence of age on an infrastructure asset. This 70 year old weir is managed by the Corporation on behalf of the Murray-Darling Basin Commission. In May 1992, a partial foundation failure of the weir occurred when a portion of the upstream concrete apron collapsed which caused an uplift in the weir structure. Urgent remedial works totalling \$1.8 million were carried out by the Corporation. However, recent independent engineering advice received by the Corporation has recommended replacement of the weir due to its age and poor condition. This replacement process is estimated to cost \$36 million and the Corporation expects funding will be provided jointly by the Commonwealth, Victorian, New South Wales and South Australian Governments.

3.4.51 In terms of the condition of headworks assets, such as dams and storages, a predecessor body of the Corporation engaged an international dam consultant in 1984 to carry out a review of 112 ageing major headworks. The consultant subsequently recommended that priority safety and remedial works be undertaken at 10 dams. At the date of preparation of this Report, works had been completed on 7 dams with works on the remaining dams currently in progress or still under consideration by the Corporation.

3.4.52 The aged asset base of the Corporation's rural water system has led to significant losses of water, particularly through evaporation from open channels and to the major environmental problem of salinity due to seepage from channels.

3.4.53 In recognition of the problems associated with the aged condition of its water supply infrastructure assets, the Corporation developed, in September 1992, a draft asset management strategy. As part of performance contracts for 1993-94 between the Corporation Board and its 5 regional management boards, responsibility for revision of the draft strategy and development of related asset management plans has been assigned to the regional boards. The Corporation recently advised audit that only one region has prepared a draft asset management plan which the other 4 regions are using as a model for the development of their plans.

3.4.54 The Corporation has also developed preliminary cost estimates governing the operation, maintenance and renewal of all headworks assets. These preliminary cost estimates indicate that over the 3 year period to 1995-96, operating and maintenance expenditure is expected to amount to \$48 million, and capital expenditure on headworks and dam safety is estimated to be around \$38 million.

3.4.55 In summary, the State's rural water reticulation infrastructure is aged and substantial levels of expenditure on asset replacements and maintenance will be required in future years to upgrade its condition.

□ *RESPONSE provided by Managing Director, Rural Water Corporation*

The Corporation agrees with the conclusions. Independent reviews of headworks and rural infrastructure are being arranged jointly by the Office of Water Reform (Department of Conservation and Natural Resources) and Office of State Owned Enterprises (Department of Treasury) to verify the condition of the infrastructure and future funding requirements in the context of the current Water Industry Reforms. The Corporation will be actively involved in these reviews.

Rationale for Northern Mallee pipeline project

3.4.56 The aged condition of the Corporation's water reticulation infrastructure can be effectively illustrated by reference to a major replacement project of the Corporation. This project, the Northern Mallee pipeline project, was recently examined by audit and is an example of a current activity designed to upgrade a significant element of the water reticulation network. The project is aimed at overcoming serious water quality, wastage, and environmental problems which have been experienced with the open channel system within the Wimmera-Mallee region.

3.4.57 The Wimmera-Mallee region of Victoria contains no permanent streams or good quality groundwater reserves. In order to facilitate economic development of the region, an open channel water supply system was constructed between 1880 and 1920 to provide local communities with regular supplies of quality water.

3.4.58 **The area's water supply system, which is known as the Wimmera-Mallee Stock and Domestic Supply System, is the largest water supply system of its type in the world.** It incorporates a channel length of 16 000 kilometres comprising 10 000 kilometres of channels owned by the Corporation and 6 000 kilometres of on-farm channels which service approximately 2.9 million hectares of land. The system provides water to around 51 towns with a population of approximately 70 000 people, 24 000 farm dams and a small irrigation area. Water supplies to the system are delivered predominantly by natural flow from The Grampians.

3.4.59 Several studies undertaken over the years by the Corporation's predecessors have identified a need for the existing open-channel system of water delivery to be replaced by a pipeline system.

3.4.60 The most recent study, known as the Wimmera-Mallee System Study, was commenced in 1988 for the purpose of developing a strategy for the management and operation of the area's water supply system into the next century. A draft discussion report on the study was issued in December 1991 (a final report is still to be released) and recommended the multi-staged pipelining of the Northern Mallee sector of the region as the principal long-term means of addressing serious deficiencies experienced with the area's open channel system.

3.4.61 The various factors identified in the draft report on the study which reinforced the need for replacement of the open-channel system by a pipeline network are summarised below:

Substantial losses of water through seepage and evaporation

3.4.62 The study found that an estimated 110 000 megalitres of water, or approximately 60 per cent of all water released from storages in the region, is lost annually through seepage and evaporation. The Corporation considers that the pipelining of the northern sector of the region will generate annual savings of approximately 68 800 megalitres, or around 55 per cent of the total quantity of water lost annually through seepage and evaporation. **It estimates that this level of annual savings is equivalent to the amount of water used by the City of Ballarat over a period of 4 years.**

3.4.63 As an illustration of the extent of water losses which can occur in the northern sector of the region, a late summer water allocation of 100 megalitres was required in the Ouyen area earlier this year and, in order to service this delivery allocation, the Corporation had to release around 2 200 megalitres from its storages. **In other words, around 95.5 per cent of water released was lost through seepage and evaporation giving a delivery efficiency of only 4.5 per cent.**

Major water quality problems

3.4.64 The study found that the Wimmera-Mallee region suffered from poor water quality due to high salinity, excessive levels of nutrients from domestic and industrial discharge and agricultural run-offs, and high turbidity in terms of the muddiness of water. Some indication of the water quality problems can be derived from Table 3.4C, compiled by audit, which compares water quality in 4 of the region's townships, as determined by the Corporation's water laboratory, against standards established by either the World Health Organisation or the Government's Environment Protection Policy.

**TABLE 3.4C
WATER QUALITY ANALYSIS FOR SELECTED TOWNSHIPS**

	Salinity (electrical conductivity)	Chloride	Turbidity	Colour	Acidity
Maximum standard	1 000	250	5	15	6.5 to 8.5
Townships -					
Sea Lake	1 466	318	14	15	8.1
Manangatang	1 395	278	16	12	7.8
Birchip	1 199	248	9.7	21	8.0
Ouyen	1 301	267	11.7	22	8.1

Note: Analysis is based on average results covering 10 year period 1984 to 1993.

3.4.65 The above table indicates that the quality of water in the 4 townships does not compare favourably with all of the maximum prescribed standards, with major differences in terms of salinity and turbidity levels.

Assets in urgent need of repairs and maintenance

3.4.66 The extremely poor condition of assets comprising the area's water supply network is reinforced by the following information recorded in the Corporation's asset management system:

- approximately 8 per cent of the 14 000 system structures could be in danger of collapse and 47 per cent of the remaining structures require maintenance;
- many channel banks are in need of repairs; and
- 60 per cent of channel waterways and 44 per cent of urban pipelines require attention.

3.4.67 While the 1991 study indicated that an additional \$210 000 should be spent annually on maintenance to bring the above assets to an acceptable condition, the Corporation has advised audit that its most recent estimate of required maintenance expenditure is that \$500 000 a year, over and above past expenditure levels, is now required over the next 4 years in order to maintain current service levels without any additional losses of water.

Security of water supply significantly below that of other regions in the State

3.4.68 The security of water supply of the region (i.e. a reasonable assurance of continuity of supply) is significantly below that of other regions in the State. The Corporation has estimated that an additional 20 000 megalitres of water a year would be needed to equate the level of security of supply within the area to that of other regions.

Impediments to environmental flows

3.4.69 Environmental flows are special water releases into a natural stream or wetland for the purpose of restoring or maintaining the in-stream habitat conditions for aquatic-based flora and fauna.

3.4.70 The study found that the regulated use of rivers within the region for water supply purposes has markedly altered their flow patterns and adversely affected the in-stream habitat conditions for fish and other aquatic species.

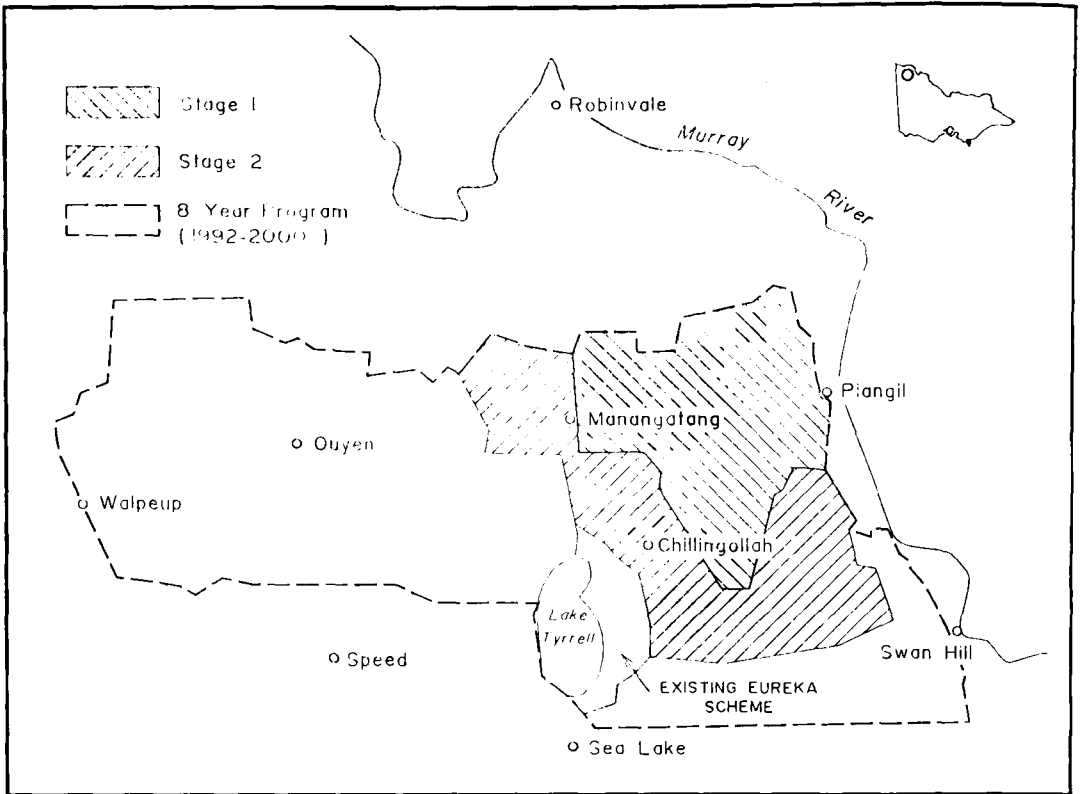
3.4.71 The environmental degradation of the Wimmera River was clearly illustrated in 1991 when the Department of Conservation and Natural Resources advised the Corporation that although the Wimmera River had outstanding environmental potential it had "... *the dubious honour of being one of the 5 most degraded river systems in the State*".

3.4.72 It can be seen that the Corporation's draft 1991 report on strategies for the future management of the region's water supply system identified a range of important factors which highlighted the need for replacement of the open channel system with a network of pipelines.

Construction of stage 1 of the pipeline project

3.4.73 The 1991 study canvassed a range of options for replacement of the open channel system. Its recommended option, which involved the pipelining of water obtained from the Murray River to service 500 000 hectares in the Northern Mallee region, accompanied by system efficiency improvements and tariff reforms, was subsequently adopted by the Corporation. **The adopted option comprises construction of works in 8 separate stages at an aggregate cost of \$49 million, with projected water savings, as estimated by the Corporation, of 68 800 megalitres a year.**

3.4.74 The following map depicts the area to be covered by the planned 8 stages of the pipeline project.



3.4.75 Following a process of negotiations by the Corporation with both Commonwealth and State Governments, agreement was reached for funding of stage 1 of the project, at an estimated cost of \$5 million, on the basis of the Commonwealth providing \$2.1 million, the State Government \$2.1 million and the Corporation \$800 000. The costs of on-farm works, met by the local farming community in order to draw water from the pipeline network, totalled \$1.8 million.

3.4.76 Construction of stage 1 of the project commenced in April 1992 and was completed on time and within budget. It was officially opened by the Minister in June 1993.

3.4.77 Stage 1 involved the laying of 400 kilometres of pipeline in the Piangil-Manangatang area of the region to supply 120 000 hectares of land. Water for the pipeline is passed from the Murray River through a computer-controlled, sand filtration process and pumped to a water storage tank located on high ground to be gravity-fed into the underground pipe network.

3.4.78 The Corporation has identified that substantial benefits have resulted from stage 1 of the project, in terms of savings of water as a scarce resource and in releases of water for environmental flows. It estimated that stage 1 has generated annual water savings of 11 500 megalitres, with 7 200 megalitres of this saving made available for the environmental flows, (the first release for environmental purposes occurred in December 1993). In addition, the pipeline has provided better quality water to the local community.

3.4.79 Significant early benefits in the form of water savings and environmental flows have followed completion of the first stage of the Northern Mallee pipeline project.



Laying of the Northern Mallee pipeline.

Issues concerning future funding of project

3.4.80 Following finalisation of arrangements for stage 1, the Corporation initiated negotiations with a view to obtaining agreement at both Commonwealth and State Government levels for the provision of further funding for the second stage of the project.

3.4.81 The second stage involves the laying of approximately 400 kilometres of pipeline servicing 140 000 hectares at an estimated cost of \$5.1 million. On-farm works were estimated to cost \$2.4 million. Targeted annual water savings are envisaged to be around 9 500 megalitres, of which about 6 500 megalitres is anticipated to be available for environmental flows.

3.4.82 Following negotiations, both the Commonwealth and State Governments determined that funding would **not** be provided for stage 2 from 1993-94 budget programs. In order to assist in maintaining the project's momentum, the Corporation determined to allocate an amount of \$730 000 from its resources for the laying of 67 kilometres of pipeline during 1993-94 which enabled commencement of initial work under stage 2.

3.4.83 The Corporation advised audit that a further submission for additional funding was submitted to the Government as part of the 1994-95 budget preparation process. In addition, the Corporation indicated that commitments had been received from the local farming community for on-farm works to link farming properties to the proposed stage 2 of the pipeline, pending provision of government funding. **The Government has recently announced in its April 1994 Autumn Economic Statement that funding of \$2.5 million will be provided towards the cost of stage 2 of the project.**

3.4.84 The provision of financial assistance towards construction of projects such as the Northern Mallee pipeline is obviously a matter which requires careful consideration by government. Factors which would normally be taken into account by government before decisions are reached on whether or not to allocate scarce resources to such projects include:

- evaluation of estimated costs and benefits incorporating both economic and social factors;
- specific assessment of potential environmental benefits;
- identification of proposed contributions by the local community towards initial construction, compared with benefits likely to accrue to the community, and towards on-going operation and maintenance; and
- the overall importance of the project in terms of the economic development of the region and, as a consequence, of the State.

3.4.85 In such circumstances, it is important that the Corporation ensures that the strongest possible case for funding of the pipeline project is presented to the Government.

3.4.86 During the course of the review, audit conveyed to the Corporation a number of suggestions for enhancing the overall quality of any future funding submissions to the Government on the remaining 6 stages of the pipeline project. The audit suggestions are summarised below:

- There is a need for the Corporation to update the various issues canvassed in its 1991 study of the Wimmera-Mallee water supply system and to issue a final report on the subject. Such action would enable the Government to have available a more complete basis for its consideration of the costs and benefits associated with the project;
- The Corporation's funding submissions to date have not been supported by an analysis of the cost and environmental implications if construction of any or all of the remaining stages of the project did not take place. Audit was advised by the Corporation that substantial levels of additional costs to both the Government and the region would result if the open channel water supply system was not replaced by a pipeline. The poor condition of assets within the region has already required additional outlays of at least \$500 000 annually for repairs and maintenance to bring those assets to an acceptable condition. The Corporation also indicated that cessation of the project would have an adverse impact on the overall economic viability of the region and could hinder, through higher cost structures for water supply, potential new industries such as mineral sands mining, grape growing and tanning operations within the region. To assist the Government's assessment of the relative merits of the pipeline project, the Corporation should ensure that future funding submissions are supplemented by an impact statement which clearly articulates the likely cost and other ramifications in the event of cessation of the project; and
- In its submissions on the project, the Corporation has focused primarily on the need for significant contributions from the State and Commonwealth Governments with minimal consideration given to alternative funding options. Given the economic, social, and environmental benefits expected to arise from completion of the total project, the Corporation should develop alternative funding options such as contributions from regional shires, establishment of farmer or industry co-operatives to construct particular segments of the project, or potential use of private sector developers to construct and operate the pipeline on a commercial basis. The identification of alternative funding options would assist the Government in its consideration as to whether the characteristics of the project warrant a more equitable spread of the funding burden between government and the local community.

3.4.87 The Corporation should take action to ensure it is presenting the strongest possible case for future government funding of remaining stages of the Northern Mallee pipeline project.

□ RESPONSE provided by Managing Director, Rural Water Corporation

The general context and conclusions are supported but the benefits of regional development should be more prominent.

The Wimmera Mallee System Study and 6 community-based Land and Water management plans have highlighted issues that need to be addressed to protect the environment and viability of the region and pipelining is a fundamental part of the solutions.

HYDRO-ELECTRIC SCHEMES AT WATER STORAGES

3.4.88 For many years now, the State Electricity Commission of Victoria (SECV) has generated hydro-electric power from 3 water storages (Eildon Reservoir, Dartmouth Dam and Cairn Curran Reservoir) under agreements with the Rural Water Corporation.

3.4.89 In 1987, as part of the Government's energy policy on renewable energy, developers were encouraged to build, own, and operate small hydro-electric schemes at water storages. Under such schemes, developers were able to sell electricity to the SECV at special incentive electricity buyback rates.

3.4.90 Since 1987, 8 small hydro-electric schemes have been arranged as renewable energy initiatives by the Rural Water Corporation and Melbourne Water Corporation with private sector developers. In addition, the Melbourne Water Corporation owns and operates a small hydro-electric facility at its Thompson Dam. Details of the 9 small projects are shown in Table 3.4D.

**TABLE 3.4D
SMALL HYDRO-ELECTRIC SCHEMES IN VICTORIA**

<i>Water storage</i>	<i>Developer</i>	<i>Plant capacity MWH (a)</i>	<i>Estimated average annual output GWH (a)</i>	<i>Actual or expected commissioning date</i>
Rural Water Corporation -				
Blue Rock Dam (b)	Kvaerner Boving ANZ	2.4	13.2	April 1992
Lake William Hovell (b)	Pacific Hydro	1.6	6.6	May 1994
Lake Glenmaggie (b)	Pacific Hydro	3.8	13.6	May 1994
Yarrowonga Weir	Kilpatrick Green	9.5	50.5	June 1994
Eildon Pondage	Pacific Hydro	4.5	18.6	July 1994
Goulburn Weir	Pacific Hydro	0.6	2.2	Under negotiation
Lake Eppalock	Pacific Hydro	2.7	5.0	Under negotiation
Melbourne Water Corporation -				
Thompson Dam (b)	Melbourne Water	7.5	33.0	1989
Cardinia Reservoir (b)	Kvaerner Boving ANZ	3.7	12.0	January 1994

(a) MGH=Megawatt hours and GWH=Gigawatt hours.

(b) Schemes currently in operation.

3.4.91 For all projects involving private sector developers, the 2 water corporations have negotiated royalty returns based on gross revenue expected to be derived by developers from sales of electricity. A number of factors, including developers' construction costs, were taken into account during these negotiations.

3.4.92 The Rural Water Corporation has estimated that annual royalty income from its 7 small hydro-electric schemes, based on estimated average electricity output, is likely to be around \$350 000. The equivalent estimated royalty income to the Melbourne Water Corporation from its one small privately-operated scheme at Cardinia Reservoir is \$340 000.

3.4.93 An audit analysis of the terms and conditions agreed with private sector developers under the various hydro-electric schemes identified that royalty rates negotiated by the Rural Water Corporation varied significantly between projects, **with the highest royalty rate equivalent to only around 63 per cent of the rate negotiated by the Melbourne Water Corporation in respect of the scheme at its Cardinia Reservoir.**

3.4.94 While variations in royalty rates between individual hydro-electric arrangements can be expected because of the unique characteristics of particular projects, a differential in royalty levels of the magnitude referred to above points to the need for the Rural Water Corporation to reassess the adequacy of its approach to negotiations on hydro-electric schemes. In discussions with the Corporation, audit conveyed the following suggestions for enhancing its overall procedures for any future negotiations with private sector developers:

- The Corporation would benefit from regular liaison with the Melbourne Water Corporation on its strategies in negotiations with developers;
- There is a need for the Corporation to develop a more extensive documentary trail for all key elements of any future negotiations. Audit found that the level of documented information held by the Corporation was substantially less than the information held by the Melbourne Water Corporation; and
- Formal guidelines should be established to facilitate a uniform approach in negotiations with private sector developers and to assist in preparation of contractual agreements.

3.4.95 **The Corporation should reassess the adequacy of its overall approach to negotiations with private developers in respect of small hydro-electric schemes.**

□ RESPONSE provided by Managing Director, Rural Water Corporation

Rates for the royalty payments applicable to the Corporation projects were finalised during 1988-90 while interest rates on capital were high. However, by 1992, when Melbourne Water negotiated the Cardinia Project, interest rates had fallen and enabled more favourable royalty rates to be obtained.

The only comparable negotiations during 1988-90 were being conducted in NSW and notwithstanding that these were not concluded until much later, approximately the same level of royalty payment rate as that of the RWC was attained.

Even at the rates negotiated by the Corporation in 1990 and even with the reduction in the cost of capital, negotiations with developers of small hydro-electric schemes have been delayed and in some cases deferred due to the costs involved.

The Corporation is not aware of a lack of documented information concerning negotiations with private sector developers. It is recognised that Melbourne Water analysed the Cardinia Reservoir Project in much greater detail with the advantage of a comparison with their own development of the Thompson Dam hydro generation project which they built.

The Corporation recognises the Melbourne Water approach as a model to be adopted for any future negotiations with private sector developers and has commenced discussions accordingly.

OUTCOME OF NEGOTIATIONS WITH SECV ON EILDON RESERVOIR AGREEMENT

3.4.96 Since 1955, the SECV has generated hydro-electric power using water from the Eildon Reservoir.

3.4.97 The *Auditor-General's Report on Ministerial Portfolios, May 1992*, outlined the circumstances under which the Corporation moved in May 1990 to terminate its agreement with the SECV for generation of hydro-electric power at Eildon and to negotiate a new agreement which, from its viewpoint, would incorporate more favourable terms. Such action was prompted by the absence of escalation clauses in the existing agreement to link payments by the SECV to Consumer Price Index (CPI) movements. The May 1992 Report estimated that additional revenue of \$15 million would have been received by the Corporation up to December 1991, if payments by the SECV had been based on CPI movements.

3.4.98 New terms and conditions for the hydro-electric scheme at Eildon Reservoir were agreed by the Corporation with the SECV in November 1993. These terms and conditions are to apply for a period of 7 years with effect from 1 July 1993, but with payments at the new rates backdated to 1 June 1990. The agreed terms provide, inter alia, for payment by the SECV of a fixed charge of \$350 000 a year, and an energy charge based on actual energy generation, **both CPI adjusted annually**. The Corporation also negotiated a capital contribution of \$320 000 from the SECV for certain works at Eildon Reservoir.

3.4.99 The Corporation estimates that it will receive annual revenue of around \$700 000 under the new arrangements, compared with average annual revenue of \$180 000 received under the previous agreement.

3.4.100 Although the agreed terms did not represent an optimum commercial result for the Corporation, it considers it achieved a "best possible" outcome, given that Victoria is now regarded as having a surplus supply of energy and there had been a consequential impact on the significance of energy produced from the Eildon Reservoir.

ROYAL BOTANIC GARDENS BOARD

3.4.101 The Royal Botanic Gardens comprises the South Yarra Botanic Gardens, the National Herbarium of Victoria, the Observatory Reserve and the Cranbourne Botanic Garden. In addition, the Management Board of the Gardens is responsible for the maintenance of the lands and gardens at Government House.

3.4.102 Until July 1992, the Gardens were managed internally within the former Department of Conservation and Environment. At that time the *Royal Botanic Gardens Act* 1991 established a statutory body under the control of a management board with the aim of facilitating financial stability, long-term planning and providing greater independence in the management of scientific and commercial ventures.

3.4.103 The 1993 audit undertook a review of the efficiency and effectiveness of the operations of the Royal Botanic Gardens.

OVERALL CONCLUSION

3.4.104 Since assuming responsibility for the Gardens in July 1992, audit found that the Board has made substantial progress towards meeting the aims of the legislation. Specifically, action to date has included the development of a draft corporate plan and a business plan for the period 1993 to 1997, the development of annual divisional plans for 1993-94 and the successful initiation of action aimed at increasing the level of funding and sponsorships provided from non-Government sources.

3.4.105 Despite these actions, the Board continues to face a range of challenges that need to be addressed, including a legacy of insufficient funding and overall development plans for the Gardens which have contributed to a backlog of essential ongoing maintenance, the deterioration of flora due mainly to ageing and ongoing security problems in the South Yarra Botanic Gardens and significant delays in the development of the Cranbourne Garden.

3.4.106 To meet these challenges the Board should enhance action taken to date by:

- further developing strategic planning processes and establishing performance measures as a means to manage and monitor activities;
- agreeing future base level funding requirements with government;
- maximising revenue from alternative sources, including recovering costs for maintenance of the Government House Gardens which is currently performed free of charge;
- improving visitor services; and
- finalising current actions and implementing additional initiatives related to the maintenance and redevelopment of the Gardens, the housing and registration of the National Herbarium collection, and the expansion of research and conservation activities particularly where research projects have commercial potential.

□ **RESPONSE** provided by Acting Director, Royal Botanic Gardens

Management notes audit's comment concerning the substantial progress made towards meeting the aims of the legislation since July 1992 and advises that significant action is either planned or in progress on a number of the recommendations made in the Report:

- master plans for both the South Yarra and Cranbourne Gardens are in progress;
- performance plans, which will be subject to annual review, have been initiated for each operational division providing a means of measuring progress and activity;
- a revenue generation plan for the period 1994-1996 has been approved;
- market research is being undertaken to better identify visitors;
- relationships are being developed with the tourism industry;
- new initiatives are being introduced to improve the management and maintenance of the Gardens;
- resolution is being sought as to the storage of the State Botanical Collection; and
- priority is being given to the advancement of scientific knowledge through appropriate conservation and other research programs.



Ornamental Lake at the Royal Botanic Gardens, South Yarra.

STRATEGIC PLANNING

3.4.107 *The Royal Botanic Gardens Act 1991* requires the preparation of a 3-5 year corporate plan outlining the strategies, priorities and targets of the Board. In 1993, in line with this legislative requirement, the Board prepared a draft corporate plan to cover the period from 1993 to 1997. The draft corporate plan outlines the overall mission of the Gardens, corporate objectives, key challenges and strategies, and proposed actions to meet the corporate strategies. The Board has also prepared a business plan for the period 1993-94 to 1995-96 including specific projects to be undertaken each year.

3.4.108 Audit considers that the Board has made substantial progress in developing and implementing an effective planning process. It is now necessary for the Board to build on this progress by:

- developing more detailed strategies and actions;
- re-evaluating the corporate plan to ensure that strategies outlined are achievable and prioritised in light of the likely funding levels; and
- developing more specific performance measures and targets in conjunction with regular evaluation of performance by the Board.

□ **RESPONSE** provided by Acting Director, Royal Botanic Gardens

Action has commenced to develop more detailed strategies and actions with the development of master plans for both the South Yarra and Cranbourne Gardens. The South Yarra master plan is currently in progress and is targeted for completion in 1996. It will provide a basis for the future development and maintenance of the Gardens. The Cranbourne master plan is nearing completion and will be available in April 1994. It will provide a basis for further planning for discrete areas within the Cranbourne Garden.

The Royal Botanic Gardens Act 1991 requires that the corporate plan is reviewed annually and any appropriate changes made to the plan, thereby ensuring that the plan reflects what is achievable within likely funding levels.

A performance planning process was introduced in November 1993, requiring development of specific performance measures and targets for each Division. This planning process will operate on a financial year basis, with regular evaluation of performance against targets culminating in a formal evaluation process at the end of each financial year.

FUNDING OF GARDEN OPERATIONS

Government funding

3.4.109 A major aim of establishing the Gardens as a statutory body was to enable greater financial flexibility by facilitating the generation of revenue from additional sources.

3.4.110 While proposing reductions in future government funding levels, the Board does not propose that the Gardens pursue complete financial independence. On this basis, so that the Gardens can continue to be a free community attraction, the Government will continue to provide a base level of funding. As a result, the Board and the Government have agreed that recurrent funding will be increased by \$200 000 to \$4.4 million in 1993-94 but will be reduced by \$200 000 in each subsequent year covered by the current business plan with reductions to be offset by increases in alternative revenue sources.

3.4.111 To date, no agreement has been reached with the Government as to a basic level of future government funding following the expiry of the existing business plan in 1995-96. Given that there is no current objective for the Gardens to become self-sufficient priority should be given to agreeing a future base level of funding with the Government.

□ RESPONSE provided by Acting Director, Royal Botanic Gardens

Although initial discussions have taken place, progress has been partially dependent on settling the source of government funds. Now that a decision has been made, in principle, to source the Government's contribution to the Royal Botanic Gardens (RBG) from the Metropolitan Improvement Fund (MIF), further discussions can take place concerning the operation of those funding arrangements. The MIF will enhance the possibility of more predictable grant commitments from the Government, thereby improving the RBG's ability to strategically plan its future operations.

Alternative revenue sources

3.4.112 In 1992-93, revenue from non-government sources totalled \$559 000 including sponsorships of \$190 000, rental of garden facilities of \$188 000 and investment income of \$58 000. To meet its aim of reducing the level of reliance on government funding, 2 new senior positions were created to manage and increase revenue from business activities. These activities include the leasing of buildings in the Observatory Reserve that are managed by the Board, the collection of donations from visitors, and corporate sponsorships similar to recent arrangements by the Board involving a \$2.2 million donation over 10 years from Pacific Dunlop and \$450 000 raised by the Herald and Weekly Times "*Botanic Gardens Revitalisation Appeal*".

3.4.113 The establishment of the additional positions is a positive step towards maximising revenue from non-government sources. The Board needs to continually monitor the impact of these positions on the level of funds generated by business activities and corporate sponsorships to decide whether these positions should be retained in the longer-term once all appropriate revenue opportunities have been explored. In addition, as a means of generating additional revenue and in line with the responsibility of the Herbarium to investigate and develop plant species to meet commercial applications, the Board should give priority to research projects that have commercial potential.

3.4.114 The Board has decided not to impose admission fees as a method of increasing revenue from non-government sources as this would conflict with the objective of providing free access to the Gardens. Nevertheless, the merit of introducing charges for tour groups and guided tours to recoup associated costs as well as placing a greater emphasis on public donations should be considered.

□ RESPONSE provided by Acting Director, Royal Botanic Gardens

In recognition of likely future changes in needs, the RBG has made initial appointments to additional positions aimed at maximising the revenue from non-government sources on short-term, performance-based contracts, and has established reporting mechanisms to monitor performance against agreed targets.

The RBG's Revenue Generation Plan for the period 1994-1996 addresses the issue of charges for tour groups, in addition to the issue of charges for guided tours which is being addressed currently with the volunteer tour guides. Two associated issues are also being considered which will have an effect on the timing of this initiative: the need for a larger volunteer body to be established and managed by RBG staff, and the need for an appropriate marketing and promotion strategy to be in place in order to establish an economically viable program.

The RBG has already instituted an improved system for collecting donations. New signage and donation boxes were established in November 1993, resulting in a seven-fold increase in gate donations. In addition, the design brief for the new signage system in the Gardens also takes account of the need for more prominent opportunities for donations.

Discussions commenced in February 1994 for a major 3-year plan for market research. The RBG has also joined the Melbourne Tourism Authority, the Victorian Tour Operators Association and the Cultural Tourism Industry Group in order to form greater links with this market and the tourism industry in general.

VISITOR SERVICES

3.4.115 The Board has recently established a Visitor Services Division with responsibilities extending to the South Yarra and Cranbourne Gardens including the management of education activities, visitor facilities and amenities, exhibitions and events, promotions and marketing, and sponsorship. In addition, with limited co-ordination by the management of the Gardens, numerous voluntary support groups continue to provide services such as guided tours, the operation of a gift shop and nursery sales.

3.4.116 Audit concurs with the Gardens' management that many opportunities exist to expand the current level of visitor services at the South Yarra and Cranbourne Gardens. Opportunities include:

- providing guided tours for organised tour groups;
- increasing the number of events in the Gardens;
- enhancing education services beyond school groups; and
- where cost-efficient, increasing public awareness of the Gardens' visitor facilities through appropriate marketing campaigns.

3.4.117 In many cases, these opportunities may also provide additional revenue sources for the Gardens. To maximise these benefits it will be necessary for the Visitor Services Division to actively co-ordinate and improve co-operation between the various voluntary groups currently undertaking service roles within the Gardens.

3.4.118 Prior to expanding the level of visitor services, it is necessary to clearly identify and understand the expectations of visitors. **Therefore, to ensure that the Board has access to the data necessary to formulate future strategies, a comprehensive user survey should be conducted as a matter of priority. Processes should also be implemented that provide up-to-date information on changes in visitor profiles.**

□ *RESPONSE provided by Acting Director, Royal Botanic Gardens*

The RBG is pursuing the need to increase the number of events and visitor programs in the Gardens by developing relationships with performing arts organisations, building a dedicated exhibition space in the Visitor Centre and by establishing a permanent base for the education service. Discussions are being undertaken with the Department of Education to increase their commitment to the RBG. Education programs have already been extended to include kindergartens and tertiary institutions.

Having identified the need to expand the volunteer base and to manage it from the RBG, the RBG has initiated discussions with the intention of improving the co-ordination of activities undertaken by voluntary support groups. However, these are sensitive issues and will need to be addressed diplomatically and gradually unless we are prepared to alienate our current volunteers and support groups.

The issue of visitor information is currently being addressed. Action has already been taken to obtain relevant user data in 2 areas: an Australian Bureau of Statistics quarterly survey which commenced in November 1993 and from which the first results were received in February 1994; and discussions commenced in February 1994 for a major 3-year market research plan to provide tangible data on existing and potential Gardens' users.

MANAGEMENT OF BOTANICAL COLLECTIONS

South Yarra Botanic Gardens

Condition of the Gardens

3.4.119 The Royal Botanic Gardens in South Yarra are the key asset of the Board and include the display of approximately 30 000 plants on 38 hectares of land.

3.4.120 Major challenges facing the Board in relation to the South Yarra Gardens include:

- Addressing problems associated with the ageing of much of the Gardens as indicated by a recent tree survey which estimated that over 6 per cent of trees were in a poor physical condition and nearly 22 per cent were in only a fair condition, with a projected life span limited to the next 5 to 10 years; and
- The significant reduction in the level of routine and on-going maintenance of gardens, lawns and paths over the last 15 years which has resulted in a decline in the appearance of the Gardens. This decline has been attributed to the reduced number of horticultural staff and the failure of previous management to develop and implement detailed maintenance and capital works programs.

3.4.121 Given the apparent decline in the condition of trees and the backlog of routine maintenance, it is important that the Board investigate methods of providing a greater level of maintenance so that the Gardens are returned to the quality expected of botanic gardens. To achieve this higher standard, detailed works and maintenance programs should be developed and implemented to address:

- the backlog of routine maintenance requirements;
- ongoing maintenance and special care of the more significant tree specimens; and
- replacement of trees in keeping with the Garden's future development direction.

3.4.122 At the time of the audit, management advised that a comprehensive survey of the condition and expected life span of trees, completed in late 1993, will provide a basis for future maintenance and development in the Gardens.

Automated watering system

3.4.123 The need for an automated watering system had been evident for some time with manual watering of the Gardens, especially during the summer months, requiring the time-consuming manual rotation of hoses by horticultural staff to ensure watering of all garden beds and lawns. Progressive implementation of an automated watering system was commenced in June 1993 and was completed in March 1994.

3.4.124 Given the increased availability of horticultural staff arising from the introduction of the automated system, detailed capital works and maintenance schedules should be developed to ensure that the increase in available resources is effectively utilised on identified priorities.

Conservation analysis

3.4.125 The Royal Botanic Gardens Conservation Analysis was prepared in 1992. As part of the analysis, all structures, landscape components, garden beds and botanic collections have been assessed and ranked at levels ranging between items of exceptional cultural significance, which are major priorities for conservation, to items identified as intrusive and requiring redesign or possible removal.

3.4.126 Audit commends the Board on its actions to classify the importance of the various gardens and structures as a means of facilitating future conservation and development. Further, the Board is taking action to develop a master strategy to provide a basis for the future development and maintenance of the Gardens and to assist management in ensuring that future developments in the Gardens are focused on priority areas. The Board should ensure that such analyses are updated regularly to prevent any further ad-hoc development of the Gardens.

Garden security

3.4.127 Effective security arrangements are an important aspect of the management of the Gardens. The need to provide adequate security is highlighted by a number of recent occurrences including:

- destruction by fire of the historically significant William Tell Shelter soon after substantial refurbishment works were completed in 1993;
- the theft in February 1993 of sprinkler heads laid as a test for the automated watering system; and
- the on-going problem of theft of plants from the gardens, particularly recently planted and unique specimens.



Reconstruction of William Tell Shelter following destruction by fire.

3.4.128 Security provisions at the Gardens are generally limited to the boundary fence of the Gardens. However, the fence is a limited deterrent especially in certain areas where its condition has deteriorated. Audit was advised that the repair and replacement of the boundary fence will be dependent on the approval of capital funding by the State Government. In the interim, it must be expected that security breaches will continue to occur.

3.4.129 While recognising the cost of implementing effective security over the Gardens and the need to meet other priorities, audit considers that the Board should:

- further review the possibilities for enhancing security with the aim of minimising losses and damage to the Gardens in a cost-effective manner; and
- pro-actively seek corporate sponsorship for the repair and possibly the progressive replacement of sections of the boundary fence.

□ *RESPONSE provided by Acting Director, Royal Botanic Gardens*

Condition of the Gardens

A comprehensive survey of trees was completed in November 1993 and now forms the basis for a computerised programmed tree maintenance schedule.

Automated watering system

Detailed capital works and maintenance schedules have already been developed for the immediate future in line with the recently implemented structural review, and will continue to be developed for the medium to longer-term.

Conservation analysis

Development of a site masterplan for the Gardens is currently in progress, with a targeted completion date of 1996. The masterplan will provide a basis for the future development and maintenance of the Gardens.

Garden security

Recent improvements in record keeping have provided an accurate account of Gardens stock. In addition, implementation of the new RBG Enterprise Bargaining Agreement will assist in providing greater security through the expansion of normal working hours.

Cranbourne Botanic Garden

3.4.130 The Cranbourne Botanic Garden was established in June 1970 to cultivate and conserve indigenous Australian plant species that due to either insufficient space or unsuitability of soil or climatic conditions was not possible in the South Yarra Gardens.

3.4.131 Despite some 24 years elapsing since the opening of the Garden, the development of the Garden has been extremely limited. The major reasons for this lack of development have been insufficient funding and the lack of an overall plan for the direction and future of the Garden.

3.4.132 Recent action by the Board has seen an increase in the pace of development. However, the extent and timing of future developments are still likely to be limited by the lack of an overall plan for the Garden and continuing funding constraints.

□ *RESPONSE provided by Acting Director, Royal Botanic Gardens*

Development of a site masterplan for the Cranbourne Botanic Garden is nearing completion, and will be finalised in April 1994. The master plan sets directions and goals for the next 20 to 50 years, including substantial development of the horticultural value of the site, visitor facilities and infrastructure.

The RBG's Sponsorship and Fundraising Strategy 1994-1996 encompasses a sponsorship strategy for the Cranbourne Botanic Garden and approaches have already been made to appropriate potential sponsors.

Maintenance of Government House gardens

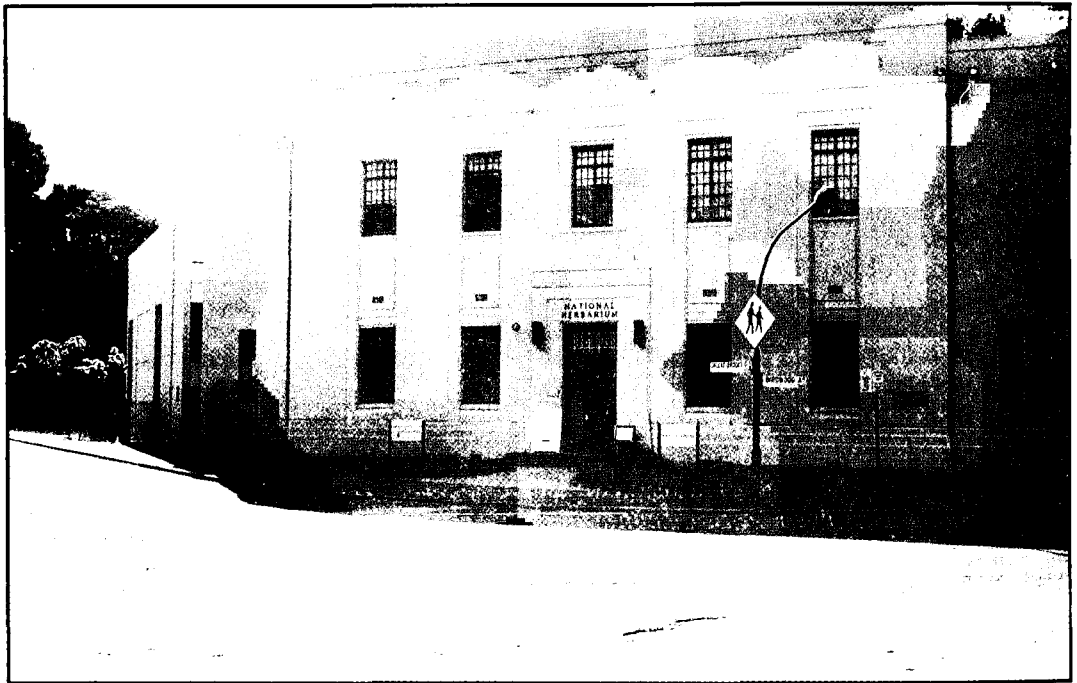
3.4.133 An arrangement has operated since 1986 whereby employees of the Botanic Gardens provide all maintenance services to the grounds and gardens of Government House. Currently, 5 full-time staff are deployed to maintain Government House grounds at an estimated cost in 1993-94 of \$175 000, excluding administrative and other overhead costs.

3.4.134 Given the more independent nature of the Gardens since the establishment of the statutory board and government policy contained in the *Guidelines for Setting Fees and Charges Imposed by Departments and Budget Agencies 1993-94*, issued by the Department of the Treasury, **action should be taken by the Board to recoup the full cost of maintaining Government House grounds.**

The National Herbarium of Victoria

Background

3.4.135 The National Herbarium of Victoria was founded in 1853 and currently undertakes the important role of research including taxonomic studies (i.e. the classification of plants), horticultural research, flora conservation activities and management of the collection of preserved plant specimens.



National Herbarium building, South Yarra.

Storage of the State botanical collection

3.4.136 A major aspect of the management of the State's preserved plant collection is concerned with ensuring the safe storage and custody of the collection. Currently, the collection is housed in the Herbarium building at the South Yarra Botanic Gardens. Individual plant specimens are stored in cardboard folders which are filed in taxonomic order in steel cabinets.

3.4.137 Audit was advised that although current storage space was adequate, it is likely that additional space will be required within the next 5 years. To address the potential shortage of storage facilities, audit was advised that the Board has approached the Government for funds in 1994-95 to acquire prefabricated storage facilities to house the non-Australian collection.

3.4.138 The action taken by the Board to address potential storage problems for the collection is commended. However, **it is recommended that the effect of separate locations on access and security be formally evaluated and the option of storing the entire collection in one secure facility be assessed. The storage facilities review should also include a full assessment of the ability of current facilities to protect the plant and library collections against fire and water damage particularly in light of water damage caused as a result of a recent rainstorm.**

Registering and accessing the collection

3.4.139 Another important facet of management of the botanical collection is effective control by registration of the collection. Although the exact number of specimens in the collection is not known, the collection is currently estimated to total over 1 million items.

3.4.140 The National Herbarium of Victoria was the last herbarium in Australia to commence development of a computerised database of its collection and remains substantially less advanced compared with other herbaria, with less than 5 per cent of the collection recorded to date. Management advised that due to a lack of in-house resources, the completion of the database is reliant on contracting external expertise and additional funding, including Commonwealth Government funding.

3.4.141 **Given the importance of the Herbarium collection and the benefits available from computerised registration, the Board should reassess the priority given to completing the registration.**

Taxonomic research

3.4.142 One of the main purposes of maintaining the Herbarium is to undertake research. To date, the focus of research has been mainly on taxonomy which involves the naming and classification of plants.

3.4.143 In recent years the major research of the Herbarium has been the production of *Flora of Victoria*. The purpose of the 4 volume publication is to provide a comprehensive and consolidated picture of flora within Victoria for use by the scientific community. The first volume was published in 1993 and it is intended to complete publication of the remaining volumes by 1997.

3.4.144 Accurate data on the cost of the project has not been determined. However, it has been estimated that the total cost of the project after including voluntary services provided to the Board will be \$760 000 over 5 years.

3.4.145 **Given the substantial resources involved, it is important that in future, the costs and benefits of these projects relative to other research projects are fully assessed.**

□ **RESPONSE** provided by Acting Director, Royal Botanic Gardens

The RBG would prefer to keep the State Botanical Collection intact and housed in one location. However, since the design of the Herbarium collection storage area makes extension of the area impractical, the RBG's preferred option is to relocate other elements of the organisation elsewhere and thus release more of the original Herbarium building for collection storage.

At present the preferred option cannot be actioned and the proposal is therefore to divide the collection, housing the less frequently used overseas collection in separate storage in prefabricated facilities on site. The Chief Botanist is satisfied that a pre-fabricated building will not place the collections at risk provided that appropriate fire protection, climate control and security systems are installed.

While the RBG accepts the need to complete the databasing of the collection, which is demonstrated by the development of annual performance plans to address this need, the scale of the task will require the RBG to continue to seek additional funds for this purpose.

The 4 volume "Flora of Victoria" fills a broader market niche than that which is suggested, appealing also to horticulturalists, students, naturalists and land managers. Sales of Volume 1 to date indicate that the general community is a key user of the "Flora of Victoria".

CONSERVATION

3.4.146 Conservation of flora is increasingly an issue of world wide concern. The Royal Botanic Gardens are part of the umbrella organisation known as the International Union for the Conservation of Nature. In 1989, the Union ratified a Botanic Gardens Conservation Strategy covering the need to actively manage endangered or threatened plant species world-wide.

3.4.147 The Gardens have recognised the important role that can be played in the conservation and recovery of threatened or endangered plant species. In particular, the corporate plan of the Gardens recognises its responsibility towards the conservation of indigenous flora through the adoption of preservation strategies and the need to establish a framework to manage and expand future conservation activities.

3.4.148 The audit disclosed that flora conservation at the Gardens comprises the maintenance of a database of threatened or endangered Victorian species, the housing of selected rare or threatened species and development of propagation methods for certain species. However, **such conservation within the Gardens currently does not address all aspects of the objectives and priorities of the Union.**

3.4.149 **Audit recommends that in developing a conservation framework, the Gardens fully consider the recommendations and priorities issued by the Union in 1989 and expand the current conservation effort by the Gardens.**

□ **RESPONSE** provided by Acting Director, Royal Botanic Gardens

In 1993, as part of an Integrated Conservation Program, the RBG started work on the ex situ conservation of several endangered Victorian species of Caladenia orchid, with the ultimate aim of reintroducing the plants into the wild.

In addition, seedlings of the rare Eucalyptus yarraensis are being raised for the Department of Conservation and Natural Resources for reintroduction into the wild, and studies are in progress to establish methods of germinating seed of the rare Euphrasia scabra.

VICTORIAN INSTITUTE OF MARINE SCIENCES

BACKGROUND

3.4.150 *The Victorian Institute of Marine Sciences Act 1974* was enacted in December 1974 and the Victorian Institute of Marine Sciences commenced operations as a Victorian statutory authority on 26 May 1976. The Institute's head office is located in Melbourne, but it also operates a research and education centre at Queenscliff and until its closure in December 1993, an education centre at Tooradin. It is also involved in a consortium with 5 of the State's universities which operate a marine research station at Queenscliff and participates in a number of other research affiliations.

3.4.151 The objectives of the Institute are aimed at increasing knowledge and public awareness of marine sciences in Australia through research and education activities. In 1993, the Institute completed 34 projects consisting of 27 commissioned research projects and 7 projects funded through Commonwealth Government research grants. In addition, over 50 000 school children and adults visited the Institute's education centres at Queenscliff and Tooradin. In carrying out these activities, the Institute incurred expenditure of \$1.3 million for the 9 months to 30 September 1993.

3.4.152 In September 1993, as a result of advice from the Institute's President that the current level of operations could not be sustained due to its deteriorating financial position and the need for a cash injection by government of \$30 000, the Minister for Conservation and Environment requested that the Auditor-General undertake a performance audit of the Institute. The subsequent audit review addressed the operations and financial position of the Institute.

OVERALL CONCLUSION

3.4.153 The Victorian Institute of Marine Sciences is a small public sector organisation which provides marine research and education services both within Victoria and throughout Australia.

3.4.154 **The audit disclosed that, while the Institute is resourced by personnel who are highly qualified in their field of marine science and provide quality research and education services, in the past there was a lack of strategic direction and monitoring of operations by the Institute's Council. This had reduced the Institute's ability to make sound decisions and contributed to the deterioration of the Institute's financial viability.** Specifically, the duties and responsibilities of the Council were not effectively discharged in that:

- the size of the Council of 24 members was excessive in comparison with other much larger public sector agencies and private companies and did not facilitate effective management or delegation;
- the full Council failed to meet between February 1991 and October 1993;
- regular meetings had not been held by the Executive Committee which had effectively assumed responsibility for managing the Institute's operations; and
- despite the decline in financial viability and liquidity since 1991, little positive action was taken to address the deteriorating financial position until the Institute's President advised the Minister of the situation in September 1993.

3.4.155 Audit also concluded that the Institute's enabling legislation was cumbersome and did not provide for the high standard of stewardship and accountability inherent in modern legislation governing other public sector entities.

OVERALL CONCLUSION - *continued*

3.4.156 Since becoming aware of the declining financial position and management deficiencies, the Department of Conservation and Natural Resources has been active in administering the operations of the Institute by fulfilling the role of caretaker and commencing a review of the options on how to best meet Victoria's marine science research and education requirements in the future. In addition, since completion of the audit, the Institute in conjunction with the Department has proceeded to implement improved information systems, taken action to ensure the Council is properly constituted and have initiated action to amend the Institute's enabling legislation to provide for greater accountability.

3.4.157 In the short-term the decision has been made for the Institute to continue operations. To ensure the longer-term viability of the Institute, a master plan will need to be developed that details the strategies for addressing the policy changes proposed by the Department as well as the deficiencies highlighted during the audit and summarised in this Report. The master plan will need to:

- incorporate a cost-benefit appraisal of all initiatives required to be implemented;
- establish priorities, time frames and deadlines for the implementation of changes to the existing management and operations of the Institute; and
- be based on an appropriate accountability and legislative framework, that is workable from the perspective of Parliament, the Council and management.

3.4.158 In the longer-term, it is understood that an evaluation by the Department of Conservation and Natural Resources will be undertaken to determine the future role of the Institute. Audit considers that the options to be evaluated should include:

- continued operations subject to the ability of the Institute to operate competitively in the market place;
- scope for expanding operations through joint or co-operative ventures; and
- the sale or closure of the Institute.

3.4.159 Areas which should be incorporated in any full economic evaluation of options for the future of the Institute include an assessment of:

- its ability to compete in the market;
- the benefits of implementing a market strategy;
- the need to encourage co-operation with industry;
- the merit of consolidating marine science resources;
- the benefits of acting as the sole Australian agent for an environmental tracing system;
- improving the reliability of future income streams;
- the costs and benefits of community services provided by the Institute; and
- the impact on consortium operations with the State's universities including its participation in the expanded marine science laboratories and toxicology aquariums located at Queenscliff.

3.4.160 If the decision is made to continue operations in the longer-term, then the financial basis for re-establishment of the Institute and future funding requirements will need to be clearly established.

LEGISLATION AND ACCOUNTABILITY FRAMEWORK

3.4.161 An accountability framework for public sector organisations, such as the Institute, is usually provided through an organisation's enabling legislation. The legislation generally establishes the mechanisms by which an organisation accounts for its operations to the responsible Minister and Parliament and delegates authority to the governing board or council to oversee and direct the organisation in achieving its objectives.

Legislation

3.4.162 Legislation passed in recent years places emphasis on the accountability and operation of public sector boards and the need to ensure board responsibilities are carried out efficiently and effectively as well as allowing for the responsible Minister to give direction. However, a review by audit of the *Victorian Institute of Marine Sciences Act* 1974 disclosed that the legislation was cumbersome, particularly the requirement that the Council comprise 24 members. In addition, the Act was silent on:

- the power of the Minister to give direction to the Institute;
- the ability of the Minister or his representative to access financial and operational information;
- the reporting of operations and briefing of activities periodically to the Minister;
- the requirement for the Council to maintain proper minutes of proceedings; and
- indemnity to Council members in carrying out their duties.

3.4.163 **The legislative framework under which the Institute operates is currently being reviewed to provide a higher standard of accountability and stewardship in line with provisions governing other public sector agencies.**

Council operations

3.4.164 Under the Act, the Institute is administered by a board of up to 24 members known as the Council. At the time of the audit, the current membership of the Council included 3 Members of Parliament, representatives of the State's universities, 6 members appointed on the recommendation of the Minister, the President and the Director of the Institute, and the Directors of the Research and Marine Science Laboratory Divisions of the Department. The Council is responsible for the operations of the Institute and for the regulation and formulation of policies relating to its operations.

3.4.165 In 1992, the Ministry of Finance issued a document entitled *Guidelines for Members of Public Sector Boards*. The document broadly defined the roles and duties of public sector boards and provided guidance on the standards expected of board members with respect to their duties and responsibilities. Specifically, a board such as the Institute's Council is required to fulfil its responsibility to:

- pursue operational objectives, using the powers granted through its enabling legislation;
- monitor operations and take necessary actions to ensure that objectives are achieved; and
- control the financial performance and ensure the ongoing viability of the entity.

3.4.166 Despite these responsibilities, at the time of the commencement of this audit review in October 1993, **the full Council had not met since February 1991**. Even with the large size of the Council, it experienced difficulty in achieving the necessary quorum of 8 members at meetings. As a result, the Council established 4 sub-committees, namely the Executive, Finance, Research and Education Committees, to facilitate the management and monitoring of the Institute's core operations. The Executive Committee assumed the greatest responsibility by largely taking on the Council's role in managing the Institute's operations.

3.4.167 Notwithstanding this delegation of its responsibilities, the audit of the proceedings of Council and sub-committees over the past 3 years revealed that the Council's responsibilities had not been effectively discharged in that:

- the size of the Council was excessive in comparison with other much larger public sector agencies and private companies and in audit opinion, was unworkable;
- Council representatives had not been reappointed in line with legislative requirements in that the term of 13 members had expired and a further 3 positions had lapsed due to non-attendance at Council meetings;
- there was a failure to evaluate financial and operating reports and plan for future operations;
- despite assuming prime responsibility for the management of operations, the Executive Committee had met only 11 times with periods of up to 5 months between meetings and the Education Committee had meet 4 times at intervals of between 6 to 8 months; and
- there was no documentation to indicate whether the Finance and Research Committees had ever met.

3.4.168 A formal accountability framework needs to be established to provide effective control over the Institute's operations and financial position and to enable the Institute to focus on its objectives. Such a framework would also ensure proper accountability to the Council, Department, Minister and the Parliament.

Organisational framework

3.4.169 The establishment of an appropriate organisational framework within any entity provides for the efficient and effective management of operations, and ensures accountability through clearly defined lines of responsibility.

3.4.170 Although the Institute currently employs about 20 full and 5 part-time employees at its 2 locations the current organisational structure of the Institute lacked clear lines of accountability to the Council by the Corporate Services and Education and Research Divisions. Specifically, audit observed that accountability was deficient in that:

- the Director of the Institute did not receive management reports from the Research and Corporate Services Divisions; and
- the tasks to be performed by management and operational staff were not defined, nor had policies been developed to guide decision-making.

3.4.171 Improvements to the Institute's organisational framework are warranted to facilitate the effective management of operations. Such improvements could be achieved by:

- clearly defining the roles and responsibilities of all employee positions; and
- appointing from within each of the Corporate Services, Education and Research Divisions a manager or head of operations to be responsible to the Institute's Director for the ongoing planning, monitoring and reporting of their respective operations.

RESOURCE MANAGEMENT

3.4.172 An organisation's ability to ensure its ongoing financial viability is facilitated through the operation of sound resource management policies and practices, including the preparation of meaningful budgets and the ongoing monitoring of performance against targeted outcomes, with any adverse performance being promptly addressed.

Financial viability

3.4.173 The review by audit of the financial results of the operations of the Institute from 1989 to 1993 indicated that although movements in income and expenditure over this period had been erratic, the reasons for the fluctuations had not been evaluated by the Institute. Accordingly, the Institute was not in a position to effectively plan future operations or identify current and potential inefficiencies as reflected in its financial performance.

3.4.174 In addition, the level of accessible cash had progressively fallen since 1991 to an unacceptable level and in the event of any unexpected expenditure or demand by creditors for payment, the Institute would have been unable to meet its obligations. The deterioration in the Institute's liquidity was reflected by a fall in cash and investment balances of 82 per cent, from approximately \$425 000 at 1 January 1991 to only \$77 000 at 30 September 1993. Sound cash and operational management requires an organisation to provide and maintain sufficient cash and investment balances to fund capital acquisition programs and meet cash expenditure which may arise in unforeseen circumstances.

3.4.175 Despite the decline in financial viability and liquidity since 1991, audit was unable to find evidence that positive action was taken to address the worsening financial position until September 1993 when the Institute's President advised the Minister that the current level of operations could not be sustained as a result of the deteriorating financial position.

3.4.176 In audit opinion, the Council's performance in allowing the level of cash and investments to decline to a point where there were insufficient funds available to meet future operational and capital investment needs is clearly unacceptable for a public sector entity.

3.4.177 To improve the financial viability of the Institute, action needs to be taken in future to ensure that:

- regular evaluations of variations between actual and budgeted performance are performed;
- cash management policies are implemented that provide for surplus cash reserves to be established for the re-building of investments to a level that sustains ongoing operations; and
- the current joint action by the Institute and the Department to improve cash flows and control expenditure is maintained.

Budget preparation

3.4.178 Effective management practice requires budgets to be prepared in a manner that provides sound justification of proposed funding and expenditure levels, particularly where public funds are involved. In the case of the Institute, audit found that budget documentation was insufficient to either support funding requests or to facilitate financial planning as:

- details of budgeted expenditure to be incurred had not been prepared;
- the outcomes expected from operations were not defined;
- the Institute was unaware of the purposes for which funding was provided by the Government;
- staff responsible for functions were not involved in the preparation of budgets; and
- due to the lack of information systems, estimated costs of operations could not be determined with confidence.

3.4.179 Given the reliance on government funding by the Institute and the financial management deficiencies that have occurred in the past, effective budgeting and financial monitoring processes are essential for all Institute activities. It is further recommended that the budget process adopted by the Institute should be in line with practices outlined in the Government's publication *A management improvement initiative for Victoria*. As part of these processes the purposes for which government contributions are received should be identified and actual expenditure monitored to ensure that funding is applied for the purpose intended.

Financial management policies and practices

3.4.180 The audit disclosed that formal resource management policies and practices to facilitate effective operations had not been developed and implemented by the Institute for the management of investments, the preparation of budgets, asset management or consortium operations.

3.4.181 In audit opinion, the absence of formalised policies had contributed to:

- the failure to identify areas of risk and opportunity;
- the inability of the Institute to address deficits on operations and activities in a timely manner;
- inaccurate costing of staff charge-out rates and administrative overheads which often resulted in the failure to recover the full-cost of commissioned research projects;
- poor management of physical and intellectual assets and the failure to address the physical deterioration of fixed assets, a situation which has reduced the Institute's ability to maximise its revenue potential;
- a lack of protection over research models developed as part of basic research projects, either through copyright or employment agreements, to ensure the Institute retained exclusive rights to the application of the assets that provide a competitive advantage to the Institute;
- research models not accounted for or valued as part of the Institute's asset base; and
- the absence of a revised formal agreement with the universities covering the expansion of consortium operations in 1991 from the original 3 universities to 5 State universities, thereby leaving the Institute unnecessarily exposed to risks.

3.4.182 The Institute has a responsibility to develop management and accounting policies and practices that facilitate effective resource management.

Management information systems

3.4.183 To enable management to make informed decisions, information provided must be accurate, relevant and timely. To achieve these objectives, management information systems must be implemented and utilised efficiently and effectively.

3.4.184 Following an examination of existing systems in operation, audit concluded that the Institute did not operate an integrated information system capable of producing complete, accurate and timely information for reliable decision-making. Specifically, existing systems were deficient in that:

- Payroll, accounts receivable and fixed assets were recorded manually. As a result, these records were not integrated with computerised ledger and accounts payable systems, resulting in excessive resources required to collate, calculate, allocate and interpret revenue and expenditure. For example, audit was informed that **3 days were required to prepare and cost the monthly payroll for an average of 25 staff**, and
- Systems to effectively monitor the financial performance of operational areas and the progress of individual research projects and education activities on a timely basis were not in existence. At September 1993, audit found that the most recent project and financial position reports available were for the period ending April 1993. As such, adequate and sufficiently detailed financial and operational information was not available to allow effective decision-making by the Council and management.

3.4.185 A cost-effective integrated information system incorporating time recording and project costing, is required to assist Institute management in decision-making and to facilitate more efficient operations. In implementing new information systems, consideration should be given to:

- the timely and reliable production of financial information and project management reports; and
- minimising resources necessary to input data and update information.

3.4.186 Accordingly, in order to ensure that future management information systems meet the Institute's requirements, there is a need for the Institute to analyse its total information needs in the context of its future operating direction and implement an information system strategy in accordance with this analysis.

Project management

3.4.187 The Institute operates 3 core education services and a research program which, in 1993, undertook some 34 research projects. These activities covered time frames ranging from a weekend course in marine science to research projects involving data collection and analysis over 12 months. In any project-oriented business, effective project management is essential to facilitate the planning, implementation and control of projects against established plans and time frames. In addition, it is essential that effective project management be complemented by an information system that records employee times, equipment usage and associated charge-out rates for each project in a manner which facilitates full cost recovery and provides for a profit margin where the project is of a commercial nature.

3.4.188 The audit of the project management processes operating at the Institute disclosed that:

- Time and cost recording was inefficient, requiring one person up to 3 days a month to complete;
- The monitoring and review of projects was not usually undertaken until the end of the financial year;
- The Institute's costing methodology for staff times did not take into account the full employment costs of research and education staff nor provide for contingencies. As such, the project charge-out rates did not reflect full cost recovery nor provide for a return to the Institute, often resulting in losses on projects;
- Time taken to complete projects often exceeded budgets and the increased costs were not always recovered;
- Actual costs of operating individual education programs for schools and the community were not maintained by the Institute and due to the paucity of information could not be determined by audit;
- Pre and post-evaluations were not undertaken in relation to education activities and therefore their effectiveness could not be established; and
- Data in relation to attendances at education programs was not maintained, therefore the Institute was not fully aware of its current or potential client base.

3.4.189 The audit concluded that the failure to have an effective project management system was an impediment to the Institute in providing efficient and economic delivery of services to its clients and the public. An effective project management system should be implemented which addresses the above deficiencies.

STRATEGIC DIRECTIONS

3.4.190 The Institute's *Strategic Directions Plan 1992-1997* was prepared in 1991-92 by a staff working party led by the Senior Research Scientist under the direction of the former Director. In December 1992, the Plan was presented and endorsed in-principle by the Minister for Conservation and Environment. **In preparing the strategic plan, the Institute had taken a significant step towards the development of an effective strategic planning framework.**

3.4.191 Audit observed that decisions made by management in formulating the *Institute's Strategic Plan 1992-1997* were focused on increasing the number of commissioned research projects and undertaking additional education activities to maximise cash flows to a level which ensured that the operations would break-even in terms of revenue and expenditure. While the aim to achieve break-even is commendable, audit found that this direction was flawed in that the real cost of providing services was unknown and had resulted in the financial base of the Institute deteriorating over several years.

3.4.192 In addition to implementing an effective project management information system, in audit opinion, the evaluation as to whether the objective of break-even through increasing income and pursuing growth in operations can be achieved should have included consideration of:

- the areas to be targeted for growth;
- the cost associated with additional growth; and
- activities that would be profitable and the level, if any, of cross-subsidisation between activities.

3.4.193 In order for strategic planning to be effective it is recommended that the Institute develop and implement annual action plans to support its strategic direction plan. Such action plans should detail the manner in which organisational objectives are met and how performance will be measured.

□ *RESPONSE provided by the Acting Director of the Institute*

The Government has recognised the deficiencies identified by the Auditor-General. In addition, the Government has been concerned about the lack of co-operation between the Victorian Institute of Marine Sciences (VIMS) and the fisheries research and educational activities of the Department of Conservation and Natural Resources.

Subject to improved accountability, the Government considers that VIMS should continue at this stage. To this end, the Government is in the process of instituting the following actions:

- Legislation to improve accountability of the Institute, including greater accountability to the Minister and replacement of the 24 person Council with a 7 person Board;*
- It is understood the Minister will require the new Board to prepare a 3 year business plan as a matter of priority;*
- Appointment of a Director who will also be the Manager of the Victorian Fisheries Research Institute within the Department. This will facilitate joint submissions for research contracts and permit the successful education program to reach a wider audience;*
- Upgrading the financial and project management systems. A draft 1994-95 budget has been agreed to in-principle by the Council, subject to later approval by the proposed Board. The draft budget identifies the purposes to which government funds would be directed and details program revenues and expenditures which will be the responsibility of division heads; and*
- One-off support during 1993-94 of \$170 000 to restore liquidity.*

The Government has indicated that it will closely monitor the performance of the Institute under these new arrangements over the next 2 years, to assess whether research and education programs are cost efficient and achieving their objectives.

The Minister for Natural Resources has been responsible for the Institute since 1 March 1994.

**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

DEPARTMENT OF CONSERVATION AND NATURAL RESOURCES

<p><i>Second Reports, 1985-86 and 1986-87. Ministerial Portfolios, May 1989, pp. 45-6. May 1990, pp. 68-70.</i></p>	<p>Deficiencies in the debtors/revenue collection system. Potential interest forgone.</p>	<p>The level of outstanding debt increased slightly during 1993. At February 1994, debtors amounted to \$11.1 million (\$10.6 million in January 1993), and outstanding arrears in excess of 6 months amounted to \$2.7 million (\$2.3 million in January 1993).</p> <p>The Department has advised that it has recently commenced action to effect a significant improvement in its outstanding debtors.</p>
<p><i>Ministerial Portfolios, May 1989, pp. 46-8.</i></p>	<p>Need to improve the accountability and monitoring of the activities of committees of management.</p>	<p>No action has been taken on the results of a State-wide review of committees of management completed by the Department in March 1992. However, the newly-formed Crown Lands and Assets Division within the Department is to undertake a review of the activities of committees of management.</p>
<p><i>Ministerial Portfolios, May 1992, pp. 73-5.</i></p>	<p>The proposed sale of certain of the Department's softwood plantations did not proceed as envisaged in 1991.</p>	<p>The Victorian Plantations Corporation was established on 1 July 1993 to manage the softwood plantations.</p>

ENVIRONMENT PROTECTION AUTHORITY

<p><i>Ministerial Portfolios, April 1991, pp. 63-4.</i></p>	<p>While audit could not quantify the degree to which the enforcement function has suffered because of the Authority's human resource base, audit considered that this could have a negative impact on the timeliness of pollution investigation.</p>	<p>Legislative changes provide for self-monitoring by industry which is supported by enforcement action by the Authority.</p>
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MELBOURNE WATER CORPORATION

<p><i>Ministerial Portfolios, May 1993, pp. 68-84.</i></p>	<p>While Melbourne Water gained significant benefits from the arrangement with MITS to supply all IT services, shortcomings in cost management meant that cost savings were not maximised. In addition, the transfer of all significant IT expertise left Melbourne Water in a position of dependence on MITS for strategic and technical management advice.</p>	<p>The 1993-94 outsourcing negotiations have substantially improved the cost efficiency of IT services provided by MITS. Melbourne Water's IT management capabilities have been strengthened by the appointment of an experienced IT professional to head its Corporate Business systems division. For further comments, refer paragraphs 3.4.21 to 3.4.39 of this Report.</p>
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SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED - continued

<i>Ministerial Portfolios, May 1993, pp. 84-9.</i>	Significant sewer collapses in 1992 and 1993 resulted in outlays of around \$13 million by the Corporation on repair works and caused major temporary pollution to the Maribyrnong River and bayside beaches. In response to the collapses, the Corporation instigated immediate and long-term remedial strategies and established a new high-priority program for sewer repairs and renewals called <i>Operation Sewer Safe</i> .	The Corporation has made significant progress in upgrading its strategic management of the sewer infrastructure. For further comments, refer to paragraphs 3.4.40 to 3.4.44.
<i>Ministerial Portfolios, May 1993, pp. 92-3.</i>	Need for effective corrective action on potential risks associated with fraudulent activity within the Corporation.	Following a series of defalcations which occurred during 1993 the Corporation commissioned two consultancy reviews to assess fraud risk. It also established a special internal controls working group to analyse the results of the consultancy reviews and to co-ordinate implementation of strengthened fraud management strategies throughout the Corporation.

STATE SWIMMING CENTRE COMMITTEE OF MANAGEMENT

<i>Fourth Report, 1983-84, pp. 76-7. Ministerial Portfolios, May 1993, pp. 65-6.</i>	Action required to recover costs and obtain compensation for structural defects in the Centre's building.	Position now finalised. In September 1993, the Government accepted an amount of \$5.75 million in settlement of the damages claim brought against the consulting engineers.
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NON-METROPOLITAN WATER AUTHORITIES

<i>Second Report, 1985-86, p. 197. Ministerial Portfolios, May 1990, p. 348.</i>	Inadequacies in the recording of fixed assets by water authorities.	The Department of Conservation and Natural Resources has issued policies and guidelines to authorities to assist in the development of asset registers. Certain authorities have been given grants to develop registers.
<i>Ministerial Portfolios, May 1991, pp. 91-2.</i>	In many cases where water authorities are administered jointly with municipalities, information was not available to substantiate charges levied by the municipalities for administrative services performed on behalf of the water authorities.	The Department has issued appropriate guidelines to the relevant authorities which emphasise the need for accurate cost allocations. The Government's October 1993 Reform Statement for the water industry has signalled action aimed at eliminating cross-subsidisation between municipalities and authorities.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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NO ACTION TAKEN

ALPINE RESORTS COMMISSION

<p><i>Ministerial Portfolios, April 1991, p. 408.</i></p>	<p>There was an absence of appropriate performance measures which provide assurance to the Government that the Commission is meeting the aims of the Tourism strategy and fulfilling its role and objectives under its legislation.</p>	<p>Position unchanged.</p>
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ENVIRONMENT PROTECTION AUTHORITY

<p><i>Ministerial Portfolios, April 1991, pp. 59-60</i></p>	<p>The Authority needs to extend its role into the areas of environment protection and pollution prevention to more adequately fulfil its role.</p>	<p>Position unchanged. The Authority has advised that it has not taken action because such powers were rejected by the Parliament in the Environment Protection (Fees and Penalties) Bill 1990.</p>
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MELBOURNE WATER CORPORATION

<p><i>Second Report, 1986-87, pp. 164-5. Ministerial Portfolios, May 1990, p. 343. May 1992, p. 432.</i></p>	<p>The enabling legislation does not confer on the Corporation the authority to levy interest on arrears of rates and charges. In contrast, the legislation of other major rating bodies provides for the levying of interest on overdue amounts.</p>	<p>Position unchanged.</p>
<p><i>Ministerial Portfolios, May 1993, pp. 90-1.</i></p>	<p>The delay and subsequent breakdown in negotiations on the joint venture relating to the Braeside park project resulted in substantial costs to the Corporation and a delay in disposal of the property.</p>	<p>Position unchanged. The Corporation is awaiting an improvement in the property market before reassessing the potential for sale of its Braeside property.</p>

NON-METROPOLITAN WATER AUTHORITIES

<p><i>Ministerial Portfolios, May 1990, pp. 347-8.</i></p>	<p>Due to industrial action, publicly-funded fluoridation assets to the value of \$3.3 million remain idle at certain water authorities.</p>	<p>Position unchanged. The Department has informed audit that the Department of Health and Community Services Victoria is attempting to resolve the issue.</p>
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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

Entity	Financial year ended	Reporting to Parliament	Financial statements signed by entity	Auditor-General's report signed
COMPLETED AUDITS				
Department of Conservation and Natural Resources	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	29 Oct. 1993	3 Nov. 1993
CONSERVATION AND ENVIRONMENT				
Bundoora Park Committee of Management	30 June 1993	No reporting requirements. <i>Crown Land (Reserves) Act 1978 s.15</i> provides for the audit of the accounts.	17 Nov. 1993	28 Mar. 1994
Environment Protection Authority	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8.</i>	31 Aug. 1993	22 Sept. 1993
Olympic Park Management	30 June 1992	No reporting requirements. <i>Crown Land (Reserves) Act 1978, s.15</i> provides for the audit of the accounts.	1 July 1993	29 July 1993 (a)
" "	30 June 1993	" "	25 Nov. 1993	20 Dec. 1993
Penguin Reserve Committee of Management	30 June 1992	No reporting requirements. <i>Crown Land (Reserves) Act 1978, s.15</i> provides for the audit of the accounts.	25 June 1993	27 July 1993 (a)
Recycling and Resource Recovery Council	30 June 1993	30 Sept. <i>Environment Protection (Resource Recovery) Act 1992, s.49</i> provides for audit of the accounts.	29 Sept. 1993	30 Sept. 1993
Royal Botanic Gardens Board	30 June 1993	30 Sept. <i>Royal Botanic Gardens Act 1991, s.37</i> provides for audit of the accounts.	14 Oct. 1993	14 Oct. 1993
State Swimming Centre Committee of Management	30 June 1992	No reporting requirements. <i>Crown Land (Reserves) Act 1978, s.15</i> provides for the audit of the accounts.	23 Dec. 1993	28 Jan. 1994 (a)
Victorian Conservation Trust	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	27 Sept. 1993	28 Sept. 1993 (a)
Yarra Bend Park Trust	30 June 1993	31 Oct. <i>Kew and Heidelberg Lands Act 1933, s.15.</i>	29 Oct. 1993	11 Nov. 1993 (a)
Zoological Board of Victoria	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	27 Sept. 1993	28 Sept. 1993
Zoological Board of Victoria Superannuation Fund	30 June 1991	No reporting requirements. Audit conducted at request of Treasurer.	30 April 1993	10 June 1993
" "	30 June 1992	" "	5 Nov. 1993	14 Jan. 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	Financial year ended	Reporting to Parliament	Financial statements signed by entity	Auditor-General's report signed
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COMPLETED AUDITS - *continued*

NATURAL RESOURCES

Alpine Resorts Commission	31 Oct. 1993	31 Jan. <i>Annual Reporting Act 1983, s.9.</i>	2 Feb. 1994	4 Feb. 1994
Melbourne Water Corporation	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	17 Aug. 1993	17 Aug. 1993
Melbourne Water Corporation Employees' Superannuation Fund	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	4 Oct. 1993	4 Oct. 1993
Rural Water Corporation	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	16 Sept. 1993	24 Sept. 1993 (a)

INCOMPLETE AUDITS

CONSERVATION AND ENVIRONMENT

Mount Macedon Memorial Cross Committee of Management	Years 31 Dec. 1992 and 31 Dec. 1993	No reporting requirements. Audit conducted at request of Treasurer.	Financial statements not yet received from Committee.	
Penguin Reserve Committee of Management	30 June 1993	No reporting requirements. <i>Crown Land (Reserves) Act 1978, s.15</i> provides for the audit of the accounts.	Financial statements only recently received from the Committee.	
Port Bellarine Committee of Management	Years 30 Sept. 1992 and 30 Sept. 1993	No reporting requirements. <i>Port Bellarine Tourist Reserve Act 1981, s.21</i> provides for the audit of the accounts.	Audits substantially completed.	
Shrine of Remembrance Trustees	30 June 1993	No reporting requirements. Audit conducted at request of the Treasurer.	Financial statements only recently received from the Trustees.	
State Swimming Centre Committee of Management	30 June 1993	No reporting requirements. <i>Crown Land (Reserves) Act 1978, s.15</i> provides for the audit of the accounts.	Audit substantially completed.	
Zoological Board of Victoria Superannuation Fund	30 June 1993	No reporting requirements. Audit conducted at request of Treasurer.	Audit substantially completed.	

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
INCOMPLETE AUDITS - continued				
NATURAL RESOURCES				
Albert Park Committee of Management Incorporated (b)	31 Aug. 1992	No reporting requirements. <i>Crown Land (Reserves) Act 1978</i> , s.15 provides for the audit of the accounts.	Financial statements not yet received.	
Victorian Institute of Marine Sciences	Years 31 Dec. 1992 and 31 Dec. 1993	31 Mar. <i>Victorian Institute of Marine Sciences Act 1974</i> , s.26.	Audits substantially completed, however the Department of Conservation and Natural Resources is currently considering amendments to the management representation for the 1992 financial statements having regard to the circumstances which led to the special audit review of the Institute.	
Victorian Institute of Marine Sciences Superannuation Fund	Years 30 June 1989 and 30 June 1990	No reporting requirements. Audit conducted at request of Treasurer.	Audits substantially completed following completion of the special review of the Institute.	

(a) Qualified audit report issued.

(b) The Committee was dissolved by the Minister with effect from 1 September 1992 and its operations merged with the Melbourne Water Corporation.

Part 3.5

Education

KEY FINDINGS

DEPARTMENT OF EDUCATION

Review of personnel/payroll system

- The lack of accountability, inefficient work practices and the lack of a strategic management focus within the Directorate of School Education have contributed in the past to the ineffective and inefficient use of resources in relation to personnel and payroll services.
Paras 3.5.19 to 3.5.41
- Outstanding salary overpayments to 2 800 staff total over \$2 million. Despite comments in previous audit reports, overpayments have continued to be a characteristic of the current personnel/payroll processing environment.
Paras 3.5.21 to 3.5.30
- The practice of utilising the temporary payroll system for a large volume of transactions is not efficient nor effective, and is a significant risk to management.
Paras 3.5.31 to 3.5.33
- The lack of integration between existing systems has resulted in duplicate and often inconsistent information leading to confusion, inaccuracies and inefficiencies.
Paras 3.5.37 to 3.5.38
- Notwithstanding that data collection and validation projects have been conducted over the past 5 years, significant errors still exist in the teacher service history database.
Paras 3.5.39 to 3.5.41
- The Directorate has appointed external consultants to assist in the evaluation and selection of a replacement personnel/payroll system.
Para. 3.5.42

3.5.1 Two Ministers, namely the Minister for Education and the Minister for Tertiary Education and Training, have responsibility for operations within the Education sector. These Ministers have collective responsibility for the Department of Education.

3.5.2 Details of the specific ministerial responsibilities for public bodies within the Education sector are listed in Table 3.5A. These public bodies, together with the Department of Education, are subject to audit by the Auditor-General.

TABLE 3.5A
MINISTERIAL RESPONSIBILITIES WITHIN THE EDUCATION SECTOR

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Education	Board of Studies Telematics Course Development Fund Trust Victorian Tertiary Admissions Centre
Tertiary Education and Training	Adult, Community and Further Education Board Colin Badger Trust Council of Adult Education State Training Board Post-secondary education institutions - 8 universities and 34 associated companies, trusts and foundations 24 colleges of technical and further education 2 university colleges Sir John Monash Business Centre

3.5.3 Comment on matters of significance arising from the audit of the Department of Education is provided below.

DEPARTMENT OF EDUCATION

REVIEW OF THE PERSONNEL/PAYROLL SYSTEM

Background

3.5.4 The Directorate of School Education's current personnel/payroll system, which caters for a total of nearly 54 000 employees, is one of the 5 largest in Australia. Salaries and associated costs totalled \$2.1 billion, or approximately 80 per cent of the Directorate's costs for the year ended June 1993. The Directorate estimated that \$16 million was expended in 1992-93 to provide personnel and payroll services. These services were provided by in excess of 320 full-time staff.

3.5.5 Table 3.5B sets out the number of staff engaged by the Directorate as at March 1994.

**TABLE 3.5B
STAFF ENGAGED BY THE DIRECTORATE, MARCH 1994**

<i>Staff classification</i>	<i>Effective full-time staff</i>	<i>Actual staff numbers</i>
Teachers	36 900	38 400
Non-teaching staff in schools	5 300	7 000
Directorate administrative staff	1 200	1 300
Staff included in the payroll who are on leave without pay	6 900	7 200
Total employees	50 300	53 900

Source: Information provided by the Directorate.

3.5.6 The magnitude of the Directorate's payroll can be illustrated by the requirement to produce approximately 90 000 group certificates in 1992-93: 50 000 for permanent employees and 40 000 for casual employees, and those who have resigned during the year. Each fortnight, approximately 50 000 pay advices are distributed to 2 300 locations with a pay advice report also going to each location.

3.5.7 In addition to the main payroll system, the Directorate also operates a temporary payroll system which processed 4 000 to 5 000 payments each fortnight during 1992-93.

3.5.8 The 2 key elements of the existing personnel and payroll systems are:

- Teacher Management System (TMS) - covering service history for teachers to assist in school staffing allocation and management; and
- General Education Network Information Utility System (GENIUS) - which provides leave management, personnel administration, salary entitlements and payroll processing for all Directorate staff.

3.5.9 Various aspects of the current personnel/payroll functions, such as the keying of batched data entry and printing and distribution of pay advices, were outsourced during the 1980s.

3.5.10 The Directorate recognises that the operation of the existing personnel/payroll system suffers from a number of shortcomings and limitations. However, new policy objectives such as the Schools of the Future (SOF) program which accompanied the reorganisation of the Directorate in 1993, have already had an impact on its operations.

3.5.11 Significant personnel reductions at central and regional locations are proposed, involving the transfer of authority and administrative responsibility to schools. All SOF principals have been assigned full responsibility for personnel/payroll operations in the following areas:

- leave;
- payroll, including changes to direct credit arrangements, deductions, taxation, overpayment recovery (new overpayments only) and increment adjustments;
- allowances;
- cessations; and
- personal details such as address changes, name changes and amendments to personal details.

3.5.12 The first implementation phase of SOF involving 317 schools commenced in the second half of 1993. It is proposed that the remaining schools will be included in the SOF program during 1994 and 1995.

3.5.13 In line with the Victorian Government policy to maximise the outsourcing of IT in public sector organisations, a *Request for Tender* was issued by the Directorate to determine options for outsourcing personnel/payroll services. A 2-phase approach has been adopted:

- Part A - covers the outsourcing of the present systems in their existing format with a decision on the successful tenderer expected in early April; and
- Part B - will cover the development and implementation of a new system to meet the ongoing needs of the Directorate and SOF. Tender documentation will be issued in April 1994 with a closing date of mid-May 1994.

3.5.14 During 1993, audit undertook a review of the Directorate's payroll and personnel functions to assess whether the management framework established by the Directorate was economic, efficient and effective. While the review identified significant shortcomings in the current system, the Directorate is considering a revised replacement personnel and payroll system which will hopefully overcome these shortcomings. The opportunity has been taken in this Report to offer various suggestions to ensure the new framework is soundly based and meets both management and user requirements.

OVERALL CONCLUSION

3.5.15 The Directorate of School Education employs nearly 54 000 staff and operates one of the 5 largest payroll systems in Australia. The Directorate estimates \$16 million is expended annually to provide personnel and payroll services. Audit acknowledges the challenges associated with the provision of personnel and payroll services of this magnitude and notes the recent actions taken by the Directorate in relation to its management structure and various proposals to overcome the deficiencies of the existing personnel and payroll system.

3.5.16 In recognition of the inherent problems which exist in the current system and the transfer of administrative responsibility envisaged by the Schools of the Future (SOF) program, the Directorate has appointed external consultants to assist in the evaluation and selection of a replacement personnel/payroll system which will more adequately serve the needs of both the Directorate and the SOF. The Directorate expects the process of decentralisation envisaged by the SOF program will overcome some of the problems of the existing highly centralised system, such as untimely advice by principals of staffing changes and absences and the elimination of inaccuracies in the personnel database.

3.5.17 Audit found there has been a **lack of accountability and strategic management focus** within the Directorate which, in audit opinion, has contributed to the **ineffective and inefficient use of resources** involved in the provision of personnel and payroll services. This is reflected by:

- **Salary overpayments.** Outstanding salary overpayments are over \$2 million, affecting 2 821 staff. Despite comments in previous audit reports, overpayments have continued to be a characteristic of the current personnel/payroll processing environment. Additionally, the continuing high level of outstanding overpayments indicate that the Directorate's recovery procedures are not operating effectively.
- **Excessive manual processing.** The practice of utilising the temporary payroll system for a large volume of transactions is not efficient or effective and, in audit opinion, represents a high risk to management in that transactions by-pass key controls and require significant manual effort.

OVERALL CONCLUSION - *continued*

- **Accuracy of personnel data.** While data collection and validation projects have been conducted over the past 5 years, significant errors still exist in the teacher service history database.
- **Duplicate data.** The lack of integration between existing systems has resulted in duplicate and often inconsistent information. Maintaining 2 duplicate and sometimes inconsistent service history and salary databases is not only uneconomic but has also led to confusion, inaccuracies and inefficiencies.

3.5.18 It is pleasing to note that the Directorate sees a major role for internal audit in monitoring the implementation of the planned reforms "... *with ongoing reporting and feedback to executive management and to the Department's audit committee*". It is important that the above deficiencies are addressed and monitoring on an on-going basis occurs in the future to ensure that the mistakes of the past are not perpetuated.

Management of the present personnel/payroll system

Shortcomings in the present personnel/payroll system

System deficiencies

3.5.19 The present computer-based system suffers from deficiencies in the following areas:

- lack of integration - the failure to integrate the current personnel and payroll systems has required many time consuming manual adjustments;
- user dissatisfaction with systems processes and output;
- inability to meet management information needs relating to human resources;
- technological obsolescence - the GENIUS software is 12 years old and suffers from functional deficiencies with the hardware in use near the end of its life; and
- inflexibility of design - because of the software design, changes (such as variation in the award structure for teachers) have been difficult to implement.

3.5.20 These factors have been instrumental in influencing the Directorate's decision to introduce major changes in the present systems.

Salary overpayments

3.5.21 Over the years, Auditor-General's Reports to Parliament have commented on the extent of salary overpayments. For example, the *Report on Ministerial Portfolios, May 1990*, highlighted a number of deficiencies in the accuracy of the database related to emergency teachers which led to substantial overpayments of between \$3.5 and \$7 million during the period 1984 to 1990.

3.5.22 Subsequent review by the Directorate covering only the period 1987 to May 1990 identified approximately \$1 million overpayments to emergency teachers. These overpayments were subsequently waived by the Treasurer on the grounds that the overpayments resulted from deficiencies in the Directorate's emergency teacher payment claim form.

3.5.23 Overpayments have continued to be a characteristic of the personnel/payroll system processing in the recent years. Table 3.5C sets out the trend in salary overpayments over the last 3 financial years and the position at 22 January 1994.

TABLE 3.5C
SALARY OVERPAYMENTS, 1990-91 TO 1993-94
 (\$'000)

	1990-91	1991-92	1992-93	1993-94
Overpayments outstanding, 1 July	4 662	3 044	2 357	3 102
Less: Repayments and adjustments(a)	2 545	1 519	1 048	1 713
	2 117	1 525	1 309	1 389
Add: New overpayments (created in current year net of any recoveries)	927	832	1 793	693
Overpayments outstanding, 30 June	3 044	2 357	3 102	(b) 2 082

(a) Adjustments include amounts written-off/waived totalling \$496 000 in the period from 1 July 1990 to 22 January 1994.

(b) At 22 January 1994.

Source: Information provided by the Directorate.

3.5.24 The increase in overpayments in 1992-93 and the balance outstanding at 30 June 1993 was mainly attributable to the use of unreliable data by the Directorate in the processing of voluntary departure packages. The level of overpayments in 1993-94 is consistent with the previous trends after excluding the impact of departure packages.

Causes of salary overpayments

3.5.25 The audit examination of the policies, strategies and procedures established by the Directorate for the management and operation of its payroll and personnel functions indicated that the following factors have contributed towards salary overpayments:

- excessive delays by school principals in notifying Directorate administrative staff of changes to teacher entitlements;
- delays by school principals in notifying the effective date teachers have commenced leave;
- untimely processing of cessation notices by Directorate administrative staff;
- problems inherent in the handling of a large inflexible payroll system, e.g. an inability to effect changes to the payroll in a timely manner; and
- inaccuracies in the personnel database.

3.5.26 According to the Directorate, the use of electronic transfer of information under the SOF program will substantially address the factors that have contributed to salary overpayments. While audit recognises that transfer of data by electronic means is a vast improvement, it will not, in itself, eliminate the underlying causes of overpayments.

3.5.27 To minimise the occurrence of overpayments, principals must ensure that all changes affecting teachers' entitlements are promptly notified to Directorate administrative staff who need to develop procedures to ensure that all changes are furnished in a timely manner and promptly processed.

Recovery of salary overpayments

3.5.28 The Directorate has given low priority to the recovery of salary overpayments in previous years. According to the Directorate, resources devoted to the recovery of overpayments were redirected towards the processing of voluntary departure and targeted separation packages. However, as the number of staff availing themselves of departure packages has declined, resources have now been redirected to the recovery of overpayments.

3.5.29 In the past 12 months, the Directorate has also engaged the services of debt collection agencies to pursue the recovery of long outstanding overpayments.

3.5.30 The continuing high level of outstanding overpayments indicate that the Directorate's recovery procedures have not operated effectively in the past but the recent initiatives will hopefully improve the situation.

Temporary payroll system

3.5.31 The Directorate operates a temporary payroll system in conjunction with its main payroll to facilitate payments to staff who, for one reason or another, are not paid through the main system, e.g. payments in advance or urgent adjustments to previous incorrect payments. As stated previously, 4 000 to 5 000 payments were made each fortnight through the facility during 1992-93.

3.5.32 The Directorate's past practice of utilising the temporary payroll system for a large volume of manual transactions represents a management risk in that:

- the transactions by-pass key controls;
- temporary payroll transactions require significant manual effort; and
- problems arising from inadequate planning and untimely advice from schools are incorrectly addressed through the temporary payroll.

3.5.33 Audit recognises that the Directorate has introduced a more stringent management process which has resulted in significant reductions in the use of the temporary payroll system to process ad hoc payments. These payments declined from \$95 million in 1992-93 to \$15 million in the current year (to 5 February 1994).

Failure to monitor cost of total personnel/payroll processing

3.5.34 Audit found that although the Directorate produces a monthly program budgetary performance report, this report does not contain comprehensive costing information specifically relating to the resources involved in its personnel and payroll processing. Without this information, the Directorate is unable to measure the economy and efficiency of its human resource activity and make fully informed decisions about resource allocation.

3.5.35 The Directorate estimated that the total cost of personnel/payroll processing for 1992-93 to be \$16 million and involved the utilisation of in excess of 320 full-time staff. As a result of implementing recommendations made by the external consultants, full-time staff involved in personnel/payroll processing as at February 1994 have been reduced to 253 with an estimated cost of \$13.9 million for 1993-94.

3.5.36 The significant savings achieved in the current year are to be commended but the failure by the Directorate, in the past, to either identify or monitor the costs involved in administering the personnel/payroll system has probably delayed the delivery of savings now being realised.

Duplicate data

3.5.37 In 1981, GENIUS was developed to process and record leave and payroll information. Since 1986, the Directorate has moved towards developing additional computer systems relating to staffing of schools and service history records. The new system, TMS, is not fully integrated with GENIUS and does not share a common database with that system. **This has resulted in the production of duplicate and often inconsistent information.** TMS was only recently enhanced to report discrepancies between the 2 systems.

3.5.38 While recognising the recent enhancements, **maintaining 2 duplicate and sometimes inconsistent service history and salary databases is uneconomic, and leads to confusion, inaccuracies and inefficiencies as represented by salary overpayments.**

Validation of service history

3.5.39 The Directorate, over the past 5 years, has conducted a number of data collection and validation projects in relation to teacher service history to improve the accuracy and integrity of its personnel data. Notwithstanding these reviews, the data is still inaccurate. To address this continuing problem, the Directorate undertook another validation exercise which involved surveying all teachers in August 1993.

3.5.40 Of the 47 500 teachers surveyed, 9 425 requests for amendment to personal details or service history records had been received at March 1994. Of these requests, 5 142 have been investigated of which 89 per cent have resulted in amendments being made by the Directorate. Audit analysed a random sample of 329 requests for amendments and extrapolated the results to the **surveyed population** with the following results:

- | | |
|--|--------------|
| ▪ Errors with financial consequences (e.g. leave, studentships) | 2.1 per cent |
| ▪ Errors relating to service history of a non-financial nature (e.g. location, classification scale, appointment type) | 9.3 per cent |
| ▪ Errors relating to personal details and having no effect on financial information (e.g. surname, address) | 6.4 per cent |

3.5.41 An overall error rate of 18 per cent (which affects 8 550 teacher records) is of concern. This rate becomes even more relevant in the case of those errors with financial consequences as they have an impact on the Directorate's budgetary position. **It is imperative therefore, that with the proposed move to the new computing environment, that the integrity of the database be established and maintained both before and after conversion.**

Replacement personnel/payroll system and issues relating to the strategic transition

Selection of a replacement personnel/payroll system

3.5.42 The introduction of the Schools of the Future program and the subsequent reorganisation of the Directorate have resulted in significant reductions in the central and regional administration, with transfer of authority and administrative responsibility to schools. As previously discussed, the existing personnel/payroll system does not fully meet management's new business requirements. **The Directorate has appointed external consultants to assist in the evaluation and selection of a replacement personnel/payroll system** which will better meet the ongoing needs of the Directorate and the SOF.

3.5.43 As previously mentioned, a 2-phase approach has been adopted covering the outsourcing of the present system and the development and implementation of a new system. In order to meet the project objective, the external consultants are required to:

- validate existing user requirements and cost analysis information;
- determine high level user and operational needs;
- develop a tender document;
- validate service level expectations of what the outsourcer is to provide;
- determine technology architecture, ownership aspects and future requirements; and
- use a comprehensive approach which is designed to guide the planning, development and implementation of integrated information systems.

3.5.44 In respect of the above project work plan, the external consultants will:

- define selection approach and evaluation mechanism;
- include steps for preparing a requirements document;
- provide guidelines for gathering information to evaluate vendors and packages;
- guide negotiations with vendor;
- develop detailed package usage approach and customisation plan;
- define technology environment to support package; and
- develop a plan for testing any new system.

3.5.45 Effective management and operational activities are dependent on complete, comprehensive and accurate data, together with reliable computer operations. It is vital therefore, that the Directorate addresses the shortcomings of the present system and give full consideration to the following issues in developing and implementing a new personnel/payroll system to ensure that the mistakes of the past are not perpetuated.

Magnitude of implementation project

3.5.46 The Directorate plans to implement the new personnel/payroll system in July 1995. The logistics of implementing such a system in a large number of schools presents a major challenge to the Directorate. **This challenge will require strong leadership and involvement by executive management in:**

- **the establishment of a policy framework for the overall direction and central monitoring of personnel systems development; and**
- **all aspects of the systems development life cycle methodology, including:**
 - development of requirements specification;
 - design alternatives;
 - testing of system application and capacity throughputs;
 - data conversion;
 - training of all users;
 - management information strategy;
 - implementation; and
 - post-implementation reviews

if the projected benefits of new systems are to be realised.

Business plans and strategies

3.5.47 Strategic directions and business plans incorporating the needs of the Directorate and the associated resource implications of implementing them should be in place. In addition, **human resource plans must be integrated with business and strategic plans.** It is vital that **present and future human resource requirements are incorporated in a human resource plan that complements the strategic directions of the Directorate.** The system should facilitate forecasting and the placement of staff in line with needs identified in the operational objectives and work plans.

User requirements

3.5.48 Although the key principle of the SOF program is the transfer of management to the school, a detailed statement of the functional and system requirements of a SOF has not yet been finalised.

3.5.49 There is an urgent need to establish, thoroughly examine and validate user requirements for personnel/payroll system in light of the organisational restructuring occurring within the education section. User requirements need to be comprehensive, current and accurate.

Systems development and review

3.5.50 Effective and efficient application systems are achieved by organisations creating the appropriate environment for development, implementation, modification and review which involves the following elements:

- proposals for systems are approved and implemented only if economically justifiable or are mandatory for software compatibility and support;
- systems are developed or modified in accordance with management approved needs, plans and procedures;
- only tested and approved systems or modifications are completely and accurately taken into production; and
- the continued effectiveness and efficiency of systems are monitored through timely post-implementation reviews.

3.5.51 It is crucial that management and user groups have active involvement in documenting, designing and implementing systems to prevent expending resources that will not satisfy their business requirements. Without user support and management commitment, the benefits of information systems may never be realised.

3.5.52 Furthermore, it is important for management to monitor, on an ongoing basis, actual costs against budget and ensure that any cost overruns are promptly identified and minimised.

IT processing and operations controls

3.5.53 Audit found that, in general, information technology controls within the Directorate have been adequate. However, it is essential that any transition to a new environment includes:

- **Error resistant operations.** Suitable error prevention and detection procedures are in place and invalid and corrupt data are identified, reported and rejected by the system;
- **Authorised use.** Only authorised personnel have access to facilities, applications and data and any breach is reported;
- **Protected system and operations.** The system and its operations are protected from various environmental and operational risks. In addition, there should be provisions for recovery, in the event of failure or destruction, that meets the immediate and long-term operational and planning needs of the Directorate; and
- **Thorough testing of programs.** The system and its operations are rigorously tested to ensure that requirements of users are met.

User interface

3.5.54 In order to maximise the efficiency and benefits of the new environment, it is essential that consideration be given to:

- **User-friendly operation.** The system provides user interfaces that are understandable and that facilitate ease of use; and
- **Training.** All users should be provided with comprehensive training to ensure that the system is fully understood.

Data integrity

3.5.55 Audit recognises the various initiatives the Directorate has taken to establish the integrity of personnel and payroll data. Considering the various shortcomings which have been experienced with the present system, **it is critical that an accountability framework be developed to ensure that complete, comprehensive, and accurate data is maintained both before and after migration.**

Reporting and accountability

3.5.56 An effective personnel/payroll system must cover the whole spectrum of human resource activity. The system should provide reliable information to assist management decision-making and to enable effective monitoring of cost and performance of human resources.

3.5.57 Considering the size of the investment, an integrated system should provide for:

- **adequate control through protection of data integrity;**
- **monitoring;**
- **historical analysis;**
- **forecasting;**
- **meaningful, flexible and timely reporting; and**
- **an audit trail.**

□ RESPONSE *provided by Secretary, Department of Education*

The more substantive problems outlined by the Auditor-General were identified by the Department in October 1992 following a comprehensive review of the payroll system by the Department's internal audit unit.

Prior to the Auditor-General's review, the Department had taken action to correct the problem. The temporary payroll system has been substantially changed and transaction volumes considerably reduced and strategic plans are in place to overcome systems and/or control deficiencies. Tenders are about to be called for a new computer-based personnel/payroll system. Management of personnel data is progressively being devolved to schools under the Schools of the Future policy to increase accountability and reduce the processing delays which have been a major cause of overpayments.

In selecting and implementing the replacement personnel/payroll system, the issues addressed in this Report will be given full consideration.

Progress of reform in these areas will continue to be monitored by the Department's Internal Audit and Review Services with ongoing reporting and feedback to executive management and the Department's audit committee.

LOSSES, THEFTS AND OTHER IRREGULARITIES

3.5.58 Table 3.5D summarised particulars of losses and thefts and other irregularities, including property damage, which occurred in 1993 and which were notified to audit by entities within the Education sector.

TABLE 3.5D
LOSSES, THEFTS AND OTHER IRREGULARITIES (a)
('\$000)

<i>Item</i>	<i>Amount</i>
Department of Education -	
Funds	15 584
Equipment	1 298 094
Property damage	7 706 123
Technical and Further Education Colleges -	
Funds	1 261
Equipment	108 799
Property damage	50 780
Total reported losses, thefts and other irregularities	9 180 641

(a) Universities are not required, under the Audit (Financial Management) Regulations 1993, to report particulars of losses, thefts and other irregularities. Former colleges of advanced education have merged with/become universities, and are therefore not required to report such particulars.

3.5.59 Major incidences of losses and thefts of funds and equipment and property damage are detailed below:

- A number of fires at schools were reported by the Department of Education. The suspected cause of many of these was arson and the Police were notified in all cases. Major fires reported and estimated damages were Eumemmerring Secondary College (\$230 000), Moe Secondary College (\$4 million), Korumburra Secondary College (\$1.2 million), Williamstown High School (\$550 000) and Mullum Primary School (\$380 000);
- Computer, stereo and musical equipment valued at \$38 000 was stolen from the Euroa Secondary College. The police were notified and action has been taken by the College to prevent re-occurrence;
- The Brunswick Secondary College was burgled and lost musical equipment valued at \$31 765. The Police were notified and the College has taken steps to have the silent alarm extended to the building burgled; and
- A Ford Fairlane, owned by the Batman Automotive College of TAFE and valued at \$23 818, was hit by another vehicle while parked in the street. An insurance claim for this damage has been settled.

**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

DEPARTMENT OF EDUCATION

<i>Ministerial Portfolios, May 1993, pp. 103-7.</i>	A large proportion of asset registers had been reported as inadequate or incomplete. These deficiencies were primarily due to the level of information system support provided by the Department, together with a lack of commitment by those responsible for maintaining the registers to ensure compliance with departmental directives.	The Computerised Administrative Systems Environment for Schools (CASES), being adopted by schools, will integrate the asset register component providing monthly automatic information interchange with the Department's centralised assets recording system.
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**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
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COMPLETED AUDITS

Department of Education	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	20 Oct. 1993	27 Oct. 1993 (a)
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EDUCATION

Board of Studies	30 June 1993	No reporting requirements. Audit conducted at request of the Treasurer.	27 Sept. 1993	28 Sept. 1993
Telematics Course Development Fund Trust	31 Dec. 1992	No reporting requirements. Audit conducted at request of the Treasurer.	29 Mar. 1993	26 Nov. 1993
Victorian Tertiary Admissions Centre	30 June 1993	No reporting requirements. Audit conducted at request of Treasurer.	24 Feb. 1994	25 Feb. 1994

TERTIARY EDUCATION AND TRAINING

Adult, Community and Further Education Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	27 Sept. 1993	30 Sept. 1993
Colin Badger Trust	31 Dec. 1992	No reporting requirements. Audit conducted at request of the Treasurer.	31 Mar. 1993	31 Mar. 1993
" "	31 Dec. 1993	" "	18 Mar. 1994	23 Mar. 1994
Council of Adult Education	31 Dec. 1992	31 Mar. <i>Annual Reporting Act 1983, s.9.</i>	31 Mar. 1993	31 Mar. 1993
" "	31 Dec. 1993	" "	18 Mar. 1994	23 Mar. 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
Institute of Educational Administration	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	16 Dec. 1993	25 Feb. 1994 (a)
Sir John Monash Business Centre Pty Ltd	31 Dec. 1992	No reporting requirements. Audit conducted at request of the Treasurer.	31 Mar. 1993	31 Mar. 1993
" "	31 Dec. 1993	" "	23 Mar. 1994	23 Mar. 1994
Post-secondary education institutions				
<i>Universities and associated companies</i>				
State Training Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	15 Sept. 1993	30 Sept. 1993
Victorian Post-Secondary Education Commission (n)	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	24 Sept. 1993	22 Oct. 1993
Australian Music Examination Board (Vic) Ltd	31 Dec. 1992	30 April. <i>Melbourne University Act 1958, s.41.</i>	3 Mar. 1993	18 May 1993
" "	31 Dec. 1993	" "	23 Feb. 1994	26 April 1994
Ballarat	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	6 April 1993	30 April 1993 (h)
" "	31 Dec. 1993	" "	27 April 1994	28 April 1994
Circular Force Proprietary Ltd (in liquidation)	31 Dec. 1992	30 April. <i>Deakin University Act 1974 s.34A.</i>	24 Mar. 1993	16 July 1993 (a)
Citytech Pty Ltd	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	10 May 1993 (b)	30 June 1993
" "	31 Dec. 1993	" "	28 April 1994	29 April 1994
Deakin	31 Dec. 1992	" "	29 Mar. 1993 (c)	16 July 1993
" "	31 Dec. 1993	" "	31 Mar. 1994	29 April 1994
Deakin University Foundation Ltd	31 Dec. 1992	30 April. <i>Deakin University Act 1974, s.34A.</i>	31 Mar. 1993	16 July 1993
" "	31 Dec. 1993	" "	25 Mar. 1994	28 April 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
<i>Post-secondary education institutions - continued</i>				
<i>Universities and associated companies - continued</i>				
Graduate School of Management Foundation Ltd	31 Dec. 1992	30 April. <i>Melbourne University Act 1958, s.41.</i>	10 Feb. 1993	18 May 1993
" "	31 Dec. 1993	" "	9 Feb. 1994	2 May 1994
Graduate School of Management Ltd	31 Dec. 1992	" "	10 Feb. 1993	18 May 1993
" "	31 Dec. 1993	" "	9 Feb. 1994	28 April 1994
Hawthorn Institute of Education Ltd	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	21 April 1993	25 May 1993
" "	31 Dec. 1993	" "	17 Mar. 1994	19 April 1994
Institute for Innovation and Enterprise Ltd	31 Dec. 1992	30 April. <i>Swinburne University of Technology Act 1992, s.44.</i>	10 Feb. 1993	18 May 1993
" "	31 Dec. 1993	" "	25 Feb. 1994	15 April 1994
La Trobe	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	27 April 1993	30 April 1993
" "	31 Dec. 1993	" "	26 April 1994	29 April 1994
La Trobe University Housing Ltd	31 Dec. 1992	30 April. <i>La Trobe University Act 1971, s.37.</i>	30 April 1993	30 April 1993
" "	31 Dec. 1993	" "	22 April 1994	29 April 1994
LaTrobe University College of Northern Victoria	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	31 Mar. 1993	29 April 1993
" "	31 Dec. 1993	" "	22 April 1994	29 April 1994
Melbourne	31 Dec. 1992	" "	19 May 1993 (b)	25 May 1993
" "	31 Dec. 1993	" "	22 April 1994	2 May 1994
Melbourne Business School Ltd	31 Dec. 1992	30 April. <i>Melbourne University Act 1958, s.41.</i>	10 Feb. 1993	18 May 1993
" "	31 Dec. 1993	" "	9 Feb. 1994	27 April 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - <i>continued</i>				
<i>Post-secondary education institutions - continued</i>				
<i>Universities and associated companies - continued</i>				
Meltech Services Ltd	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	24 June 1993 (b)	30 June 1993
" "	31 Dec. 1993	" "	8 April 1994	13 April 1994
Milake Pty Ltd	31 Dec. 1992	30 April. <i>Deakin University Act 1974, s.34A.</i>	30 Mar. 1993	16 July 1993
" "	31 Dec. 1993	" "	31 Mar. 1994	28 April 1994
Monash	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	19 Aug. 1993 (d)	19 Aug. 1993 (g)
" "	31 Dec. 1993	" "	28 Mar. 1994	13 April 1994 (g)
Monash - ANZ Centre of International Briefing Pty Ltd	31 Dec. 1992	30 April. <i>Monash University Act 1958, s.35B.</i>	25 Feb. 1993	19 Aug. 1993
" "	31 Dec. 1993	" "	3 Mar. 1994	18 Mar. 1994
Monash IVF Pathology Services Trust	31 Dec. 1992	" "	19 Aug. 1993	19 Aug. 1993
" "	31 Dec. 1993	" "	11 Feb. 1994	18 Mar. 1994
Monash IVF Pty Ltd	31 Dec. 1992	" "	19 Aug. 1993	19 Aug. 1993
" "	31 Dec. 1993	" "	11 Feb. 1994	18 Mar. 1994
Monash Merchandising Unit Trust	31 Dec. 1993	" "	31 Dec. 1993	16 Mar. 1994
Monash Merchandising Company Pty Ltd	31 Dec. 1993	" "	31 Dec. 1993	21 Mar. 1994
Monash Ultrasound Trust	31 Dec. 1993	" "	11 Feb. 1994	18 Mar. 1994 (e)
Monash University Foundation	31 Dec. 1992	" "	22 Feb. 1993	19 Aug. 1993
" "	31 Dec. 1993	" "	25 Mar. 1994	29 Mar. 1994
Montech Pty Ltd	31 Dec. 1992	" "	10 Mar. 1993	19 Aug. 1993
" "	31 Dec. 1993	" "	25 Feb. 1994	31 Mar. 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
<i>Post-secondary education institutions - continued</i>				
<i>Universities and associated companies - continued</i>				
Neurometric Systems Pty Ltd	31 Dec. 1992	30 April. <i>Swinburne University of Technology Act 1992, s.44.</i>	11 Mar. 1993	18 May 1993
" "	31 Dec. 1993	" "	25 Feb. 1994	5 April 1994
Obstetric and Diagnostic Ultrasound	31 Dec. 1992	30 April. <i>Monash University Act 1958, s.35B</i>	19 Aug. 1993	19 Aug. 1993 (e)
Opening Learning Agency of Australia Pty Ltd	Period ended 31 Dec. 1992	" "	21 June 1993	19 Aug. 1993
" "	31 Dec. 1993	" "	11 Mar. 1994	18 Mar. 1994
Pelletray Pty Ltd	31 Dec. 1992	30 April. <i>Monash University Act 1958, s.35B.</i>	22 July 1993	19 Aug. 1993
" "	31 Dec. 1993	" "	23 Feb. 1994	24 Mar. 1994
RMIT	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	10 May 1993 (b)	16 Sept. 1993
" "	31 Dec. 1993	" "	22 April 1994	29 April 1994
RMIT Ltd	31 Dec. 1992	" "	10 May 1993	26 July 1993
" "	31 Dec. 1993	" "	28 April 1994	29 April 1994
RMIT Union	31 Dec. 1993	" "	27 April 1994	29 April 1994
Swinburne Ltd	31 Dec. 1992	" "	7 April 1993	16 April 1993
" "	31 Dec. 1993	" "	23 Mar. 1994	15 April 1994
Swinburne University of Technology	31 Dec. 1992	" "	7 April 1993	16 April 1993
" "	31 Dec. 1993	" "	7 Mar. 1994	15 April 1994
Technisearch Ltd	31 Dec. 1992	30 April. <i>Royal Melbourne Institute of Technology Act 1992, s.39.</i>	3 Sept. 1993	16 Sept. 1993
" "	31 Dec. 1993	" "	25 April 1994	29 April 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
<i>Post-secondary education institutions - continued</i>				
<i>Universities and associated companies - continued</i>				
Unilink Melbourne	31 Dec. 1992	30 April. <i>Deakin University Act 1974, s.34A.</i>	31 Mar. 1993	16 July 1993
" "	31 Dec. 1993	" "	6 April 1994	28 April 1994
Unimelb Ltd	31 Dec. 1992	30 April. <i>Melbourne University Act 1958, s.41.</i>	25 Feb. 1993	18 May 1993
" "	31 Dec. 1993	" "	3 Mar. 1994	27 April 1994
Victoria University of Technology	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	5 July 1992	13 Aug. 1993
" "	31 Dec. 1993	" "	15 April 1994	27 April 1994
Victorian College of Agriculture and Horticulture Ltd	6 months ended 31 Dec. 1992	" "	21 April 1993	25 May 1993 (a)
" "	31 Dec. 1993	" "	24 Mar. 1994	20 April 1994
Victorian College of Agriculture and Horticulture	6 months ended 30 June 1992	" "	30 April 1993	25 May 1993 (a)
Victorian College of Pharmacy Ltd	18 Nov. 1992	" "	15 Dec. 1993	3 Feb. 1994 (g)
Victorian College of the Arts	31 Dec. 1992	" "	19 April 1993	30 April 1993
" "	31 Dec. 1993	" "	7 April 1994	21 April 1994
Victracc Ltd (in liquidation)	31 Dec. 1992	30 April. <i>Deakin University Act 1974, s.34A</i>	10 May 1993	16 July 1993 (m)
VUT Foundation Ltd	31 Dec. 1993	30 April. <i>Victoria University of Technology Act 1990, s.42.</i>	26 April 1994	27 April 1994 (f)
Western Institute Foundation Ltd	31 Dec. 1992	" "	14 May 1993	13 Aug. 1993 (f)

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
<i>Post-secondary education institutions - continued</i>				
<i>Universities and associated companies - continued</i>				
Western Melbourne Business Developments Pty Ltd	18 months ended 31 Dec 1992	30 April. <i>Victoria University of Technology Act 1990, s.42.</i>	5 July 1993	27 July 1993
" "	31 Dec. 1993	" "	15 April 1994	27 April 1994
Westsearch Ltd	31 Dec. 1992	" "	6 Aug. 1993	13 Aug. 1993 (m)
Winsearch Ltd (in receivership)	31 Dec. 1992	30 April. <i>Deakin University Act 1974, s.34A.</i>	25 Mar. 1993 (c)	16 July 1993 (m)
Batman Automotive College	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	26 April 1993	30 April 1993 (i)
Box Hill	31 Dec. 1992	" "	29 April 1993	30 April 1993
" "	31 Dec. 1993	" "	31 Mar. 1994	21 April 1994
Broadmeadows	31 Dec. 1992	" "	5 May 1993	4 June 1993
" "	31 Dec. 1993	" "	18 April 1994	21 April 1994
Central Gippsland	31 Dec. 1992	" "	26 April 1993	27 May 1993(a)
Dandenong	31 Dec. 1992	" "	30 April 1993	19 May 1993
" "	31 Dec. 1993	" "	27 April 1994	1 May 1994
East Gippsland	31 Dec. 1992	" "	20 May 1993	4 June 1993 (a)
" "	31 Dec. 1993	" "	17 Feb. 1994	22 April 1994
Flagstaff	31 Dec. 1992	" "	14 May 1993	11 June 1993 (l)
" "	6 months ended 30 June 1993	" "	2 Mar. 1994	10 Mar. 1994
Frankston	31 Dec. 1992	" "	17 May 1993	25 May 1993
" "	31 Dec. 1993	" "	28 Mar. 1994	17 April 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
<i>Post-secondary education institutions - continued</i>				
<i>Universities and associated companies - continued</i>				
Gordon	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	1 Mar. 1993	30 April 1993
" "	31 Dec. 1993	" "	1 Mar. 1994	19 April 1994
Goulburn Valley	31 Dec. 1992	" "	26 April 1993	19 May 1993
Goulburn Valley	31 Dec. 1993	30 April. <i>Annual Reporting Act 1983, s.9.</i>	23 Mar. 1994	12 April 1994
Goulburn Valley Driver Training Complex Ltd	31 Dec. 1992	No reporting requirements. Audit conducted at request of the Treasurer.	8 April 1993	21 May 1993
" "	31 Dec. 1993	" "	1 Mar. 1994	16 Mar. 1994
Holmesglen	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	7 May 1993	4 June 1993
" "	31 Dec. 1993	" "	6 April 1994	10 April 1994
John Batman	31 Dec. 1993	" "	13 April 1994	24 April 1994 (i)
Loddon-Campaspe	31 Dec. 1992	" "	7 June 1993	10 Aug. 1993 (a)
" "	31 Dec. 1993	" "	31 Mar. 1994	22 April 1994 (a)
Melbourne College of Decoration	31 Dec. 1992	" "	30 April 1993	6 July 1993 (j)
Melbourne College of Printing and Graphic Arts	31 Dec. 1992	" "	7 Sept. 1993	12 Oct. 1993
" "	31 Dec. 1993	" "	22 April 1994	29 April 1994
Melbourne College of Textiles	31 Dec. 1992	" "	16 Mar. 1993	17 May 1993
" "	31 Dec. 1993	" "	14 April 1994	19 April 1994
Moorabbin	31 Dec. 1992	" "	5 Mar. 1993	24 Mar. 1993
" "	31 Dec. 1993	" "	23 Feb. 1994	8 Mar. 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
<i>Post-secondary education institutions - continued</i>				
<i>Universities and associated companies - continued</i>				
Northern Metropolitan	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	17 April 1993	4 June 1993
" "	31 Dec. 1993	" "	25 Mar. 1994	21 April 1994
Outer Eastern	31 Dec. 1992	" "	27 April 1993	30 April 1993
" "	31 Dec. 1993	" "	14 April 1994	22 April 1994
Prahran	6 months ended 30 June 1992	" "	7 April 1993	21 April 1993 (a)(k)
Richmond	31 Dec. 1992	" "	20 April 1993	30 April 1993
School of Mines and Industries Ballarat Ltd	31 Dec. 1992	" "	17 Mar. 1993	22 Mar. 1993
" "	31 Dec. 1993	" "	23 Feb. 1994	28 Feb. 1994
South West	31 Dec. 1992	" "	1 July 1993	5 Aug. 1993
" "	31 Dec. 1993	" "	13 April 1994	28 April 1994
Sunraysia	31 Dec. 1992	" "	20 Aug. 1993	30 Aug. 1993
Wangaratta	31 Dec. 1992	" "	20 April 1993	25 June 1993
" "	31 Dec. 1993	" "	15 Mar. 1994	18 Mar. 1994
Western Metropolitan	31 Dec. 1992	" "	30 April 1993	4 June 1993
" "	31 Dec. 1993	" "	31 Mar. 1994	17 April 1994
William Angliss	31 Dec. 1992	" "	26 April 1993	30 April 1993
" "	31 Dec. 1993	" "	12 April 1994	19 April 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

Entity	Financial year ended	Reporting to Parliament	Financial statements signed by entity	Auditor- General's report signed
COMPLETED AUDITS - continued				
<i>Post-secondary education institutions - continued</i>				
<i>Universities and associated companies - continued</i>				
Wimmera Community	31 Dec. 1992	30 April. <i>Annual Reporting Act 1983, s.9.</i>	20 April 1993	20 May 1993 (a)
" "	31 Dec. 1993	" "	26 April 1994	29 April 1994
Wodonga	31 Dec. 1992	" "	16 April 1993	26 July 1993
" "	31 Dec. 1993	" "	2 Mar. 1994	17 April 1994
INCOMPLETE AUDITS				
Central Gippsland	31 Dec. 1993	30 April. <i>Annual Reporting Act 1983, s.9.</i>	Audit substantially completed.	
Circular Force Proprietary Ltd (in liquidation)	31 Dec. 1993	30 April. <i>Deakin University Act 1974, s.34A.</i>	Financial statements not yet received.	
Institute of Educational Administration	5 months ended 30 Nov. 1993	30 April. <i>Annual Reporting Act 1983, s.9.</i>	Ceased to exist on 30 Nov. 1993 with the proclamation of the <i>Institute of Educational Administration (Repeal) Act 1993.</i>	
Richmond	31 Dec. 1993	" "	Audit substantially completed.	
RMIT Foundation	31 Dec. 1993	" "	" "	" "
Sunraysia	31 Dec. 1993	" "	" "	" "
Telematics Course Development Fund	31 Dec. 1993	No reporting requirements. Audit conducted at request of the Treasurer	Financial statements not yet received.	

(a) Qualified audit report issued.

(b) Extension granted to 31 May 1993.

(c) Extension granted to 31 July 1993.

(d) Extension granted to 31 August 1993.

(e) Monash Ultrasound Trust was previously known as Obstetric and Diagnostic Ultrasound.

(f) VUT Foundation Ltd was previously known as Western Institute Foundation Ltd.

(g) Victorian College of Pharmacy Ltd merged with and became part of Monash University from 1 July 1992.

(h) University of Ballarat was previously known as Ballarat University of College.

(i) John Batman College of TAFE was previously known as Batman Automotive College of TAFE.

(j) Melbourne College of Decoration was divided between Western Metropolitan College of TAFE and RMIT from 1 January 1993.

(k) Prahran College of TAFE merged with and became part of Swinburne University of Technology from 1 July 1992.

(l) Flagstaff College of TAFE merged with and became part of Western Metropolitan College of TAFE from 1 July 1993.

(m) Deregistered in 1993.

(n) Abolished under the provisions of the *Tertiary Education Act 1993.*

Part 3.6

Energy and Minerals

KEY FINDINGS

GAS AND FUEL CORPORATION

New head office accommodation

- After protracted negotiations extending over 4 years to determine the most suitable building for its head office requirements, the Corporation repudiated the agreement associated with the negotiations.

Paras 3.6.3 to 3.6.10

- As a result of the repudiation, the Corporation may be required to pay compensation for cancellation of the lease.

Paras 3.6.12 to 3.6.13

STATE ELECTRICITY COMMISSION OF VICTORIA

Sale of Loy Yang B power station

- The sale of a 51 per cent share in the SECV's Loy Yang B power station for \$518.2 million represented the largest privatisation undertaken by government in Australia.

Para. 3.6.14

- Based on construction costs, the sale resulted in a deficiency of \$402 million to the SECV. This deficiency will be recouped by the SECV through a reduced power tariff over the 33 years operating life of Loy Yang B.

Para. 3.6.27

- The purchasers of Loy Yang B and the financiers enjoy the benefits of a government guarantee covering the performance of certain obligations which the SECV has to fulfil, such as the completion of construction of Loy Yang B and the purchase of power produced by the station.

Paras 3.6.46 to 3.6.53

Reform of Victoria's electricity supply industry

- Substantial restructuring of the Victorian electricity supply industry took place in October 1993, with further disaggregation of the industry proposed from 1 July 1994.

Paras 3.6.80 to 3.6.85

KEY FINDINGS - *continued*

- The Government expects the restructuring of the power industry to increase competitiveness and efficiency. However, it is important that the pitfalls experienced by several overseas countries, which have restructured their power industries, are avoided in Victoria.

*Para. 3.6.88***Outsourcing of certain activities**

- The SECV, in recognising as early as 1991 the need to take strong action to improve its efficiency and reduce costs, outsourced many of its activities, with outsource contracts valued at in excess of \$554 million at November 1993.

Para. 3.6.104

- The limited involvement in the outsourcing process by the SECV's Board may have contributed to inadequacies in the manner in which the SECV's 3 business groups identified potential outsourcing activities, arranged tenders, awarded contracts and established mechanisms to monitor the performance of contractors. This may have affected the final outcome to the SECV of a number of outsourcing arrangements.

Paras 3.6.113 to 3.6.127

- Outsourcing activities, while of considerable benefit to the SECV in terms of reducing its workforce and achieving efficiencies, have been implemented with minimal industrial unrest due largely, in audit opinion, to the inclusion of substantial financial incentives relating to the employment of ex-SECV staff, minimum work guarantees, compensation for idle resources and payments to contractors for any future redundancy costs which may arise in certain outsourcing contracts.

Paras 3.6.174 to 3.6.177

- The current annual costs of around \$35 million associated with the continuing employment of 773 surplus SECV employees are adversely impacting on projected outsourcing benefits.

*Paras 3.6.188 to 3.6.192***New head office accommodation**

- In May 1991, the Commission entered into an agreement to lease a new 40 000 square metre head office building to be constructed by a developer. The lease was for a period of 20 years at a fixed annual rental of \$32.4 million.

Paras 3.6.196 to 3.6.197

- Although construction of the building is now complete, uncertainty surrounds the future occupancy of the building due to the decline in staff numbers located within the Melbourne central business district and the restructuring occurring in the power industry. The options in respect of the building are being reviewed by the Departments of Finance, the Treasury and Energy and Minerals.

Paras 3.6.200 to 3.6.201

3.6.1 The Minister for Energy and Minerals has responsibility for operations within the Energy and Minerals sector. Details of the specific ministerial responsibility for public bodies within the Energy and Minerals sector are listed in Table 3.6A. These public bodies, together with the Department of Energy and Minerals, are subject to audit by the Auditor-General.

TABLE 3.6A
MINISTERIAL RESPONSIBILITY WITHIN THE ENERGY AND MINERALS SECTOR

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Energy and Minerals	Coal Corporation of Victoria Everton Dell Pty Ltd Gas and Fuel Corporation of Victoria Gas and Fuel Corporation Superannuation Fund Loy Yang B Power Station Pty Ltd National Electricity Pty Ltd National Power Pty Ltd Renewable Energy Authority Victoria SEC Superannuation Fund SECV International Pty Ltd SECV Superannuation Pty Ltd State Electricity Commission of Victoria

3.6.2 Comments on matters of significance arising from the audit of certain of the above entities are provided below.

GAS AND FUEL CORPORATION

NEW HEAD OFFICE ACCOMMODATION

3.6.3 In March 1989, the Gas and Fuel Corporation called for registrations of interest from owners and developers to provide a purpose-built building for the Corporation's head office. The decision was based on growing concerns about the future suitability of the Corporation's headquarters in Flinders Street, Melbourne, and the uncertainty concerning the continuing leasing of the building in view of the Government's decision that the Princes Gate Complex (within which the Corporation is located) would be demolished at the earliest opportunity.

3.6.4 In July 1989, the Corporation invited 4 developers to submit proposals for the construction of an office building of not less than 35 000 square metres, with the ability to provide for future growth, to house approximately 1 800 employees. Although the building was to be principally for the use of the Corporation, any area in excess of its needs was to be sublet. Submissions were received from only 3 of the developers.

3.6.5 An evaluation of proposals was carried out by Corporation staff with the assistance of consultants and, in March 1990, the Corporation's Board accepted a recommendation that Hudson Conway Limited be the preferred bidder. Although similar in financial terms with other proposals, the Hudson Conway bid was preferred because it provided a single occupancy building, larger floor space and better car parking facilities.

3.6.6 A lease agreement for the provision of a building of 40 000 square metres was entered into in December 1990 between the Corporation and Gleem Pty Ltd, subject to that company obtaining the required finance within a specified time for the construction of the building. The building was to be constructed at the corner of Spring and Latrobe Streets, Melbourne, on land owned by Gleem, a company in which Hudson Conway has a joint interest. Although extensions of time were granted to Gleem to obtain the finance, the company was unable to do so by July 1991 (the last extension given to Gleem) and the Corporation then exercised its right to avoid the agreement to lease.

3.6.7 Negotiations recommenced with Gleem in August 1991 for the construction of a smaller building of 21 000 square metres. The Corporation's decision to reduce the amount of required building space was a direct result of a major restructure of the Corporation, with extensive regionalisation of its activities and a general downsizing.

3.6.8 In May 1992, with the Corporation's regionalisation process underway and with a projected requirement for accommodation for approximately 930 staff in its head office, the Corporation signed an agreement with Gleem to lease for 20 years a 21 000 square metre building subject once again to that company obtaining the required finance within a specified time.

3.6.9 During March 1993, a further review was conducted by the Corporation into its accommodation needs to establish:

- whether the proposed development provided an appropriate standard of accommodation and space in view of the further downsizing of the Corporation,
- whether the cost to the Corporation of the project was competitive in the current circumstances given ongoing rental commitments and was consistent with current and likely future market conditions; and
- the cost to the Corporation of withdrawing from the commitments under the contract with Gleem, and whether withdrawal would be cost-effective.

3.6.10 After consideration of all options, the Corporation determined that the preferred option was to remain at the present location. After consultation with the Government, in May 1993 the Corporation formally repudiated the agreement to lease and, with Gleem's acceptance of the repudiation, the agreement to lease was brought to an end.

3.6.11 The parties agreed to resolve the matter of compensation by arbitration and an arbitrator was appointed, however, the Corporation was then requested to admit liability, which it declined to do. Upon legal advice, the Corporation determined that the arbitration proceedings should be discontinued and Gleem advised accordingly. Subsequently, in February 1994, Gleem issued Supreme Court proceedings claiming unspecified damages.

3.6.12 The Corporation has disclosed in its *1993 Annual Report* that, although not admitting liability, it does expect to pay some compensation to the lessor and has provided the sum of \$20 million in its financial statements.

3.6.13 The possibility that the Corporation may be required to pay compensation for the cancellation of the lease of its proposed head office can be attributed, at least in part, to the difficulties that arise in properly assessing rental requirements in a climate of continuous change. Factors which have contributed to this situation have been:

- The protracted negotiations involved in determining the most suitable building for the Corporation's requirements. Over 4 years elapsed from the time of calling registrations of interest from developers for the initial larger scheme to repudiation by the Corporation of the agreement to lease for the smaller scheme; and
- The difficulties of planning for a large head office complex and the need to enter into a long-term leasing contract at a time when the Corporation was required to achieve efficiency gains particularly by the downsizing of its activities.

□ *RESPONSE provided by Gas and Fuel Corporation*

None authorised by Gas and Fuel Corporation.

STATE ELECTRICITY COMMISSION OF VICTORIA

SALE OF LOY YANG B POWER STATION

Background

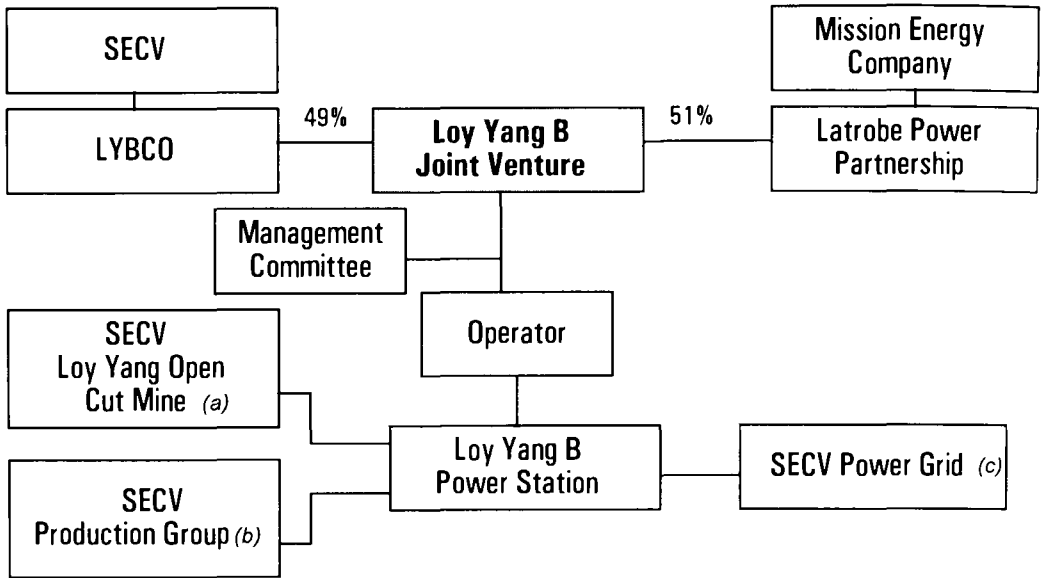
3.6.14 In December 1992, the State Electricity Commission of Victoria (SECV) sold a 51 per cent share in its Loy Yang B power station to a private operator, Mission Energy Australia Pty Ltd. The transaction, the largest privatisation undertaken by a government in Australia, involved complex and extensive financial and legal arrangements. At the time of sale, construction of Loy Yang B was only partly completed, with finalisation expected in September 1996.

3.6.15 Mission Energy is a North American company linked to its holding company, Southern California Edison Corporation. Mission Energy's share in Loy Yang B is held through a group of wholly-owned subsidiaries, collectively referred to as the Latrobe Power Partnership.

3.6.16 The SECV 49 per cent share in Loy Yang B was purchased by a wholly-owned subsidiary company, Loy Yang B Power Station Pty Ltd (LYBCO) and funded by way of a loan from the SECV.

3.6.17 Loy Yang B is to be operated by a joint venture between LYBCO and the Latrobe Power Partnership. Chart 3.6B depicts the relationship between the joint venture partners and other operational arms of the SECV.

CHART 3.6B
ORGANISATIONAL STRUCTURE FOR OPERATION OF LOY YANG B POWER STATION



(a) Provides coal to Loy Yang B.

(b) Provides miscellaneous services to Loy Yang B, such as water and sewerage.

(c) Purchaser of power.

Options for the financing and ownership of Loy Yang B

Background

3.6.18 The SECV intended to finance the construction of Loy Yang B through internal funds and borrowings. However, during the latter part of the 1980s and early 1990s, with the economic downturn, the State's debt burden and Australian Loan Council restrictions on new borrowings, the SECV found it necessary to consider alternative financing arrangements.

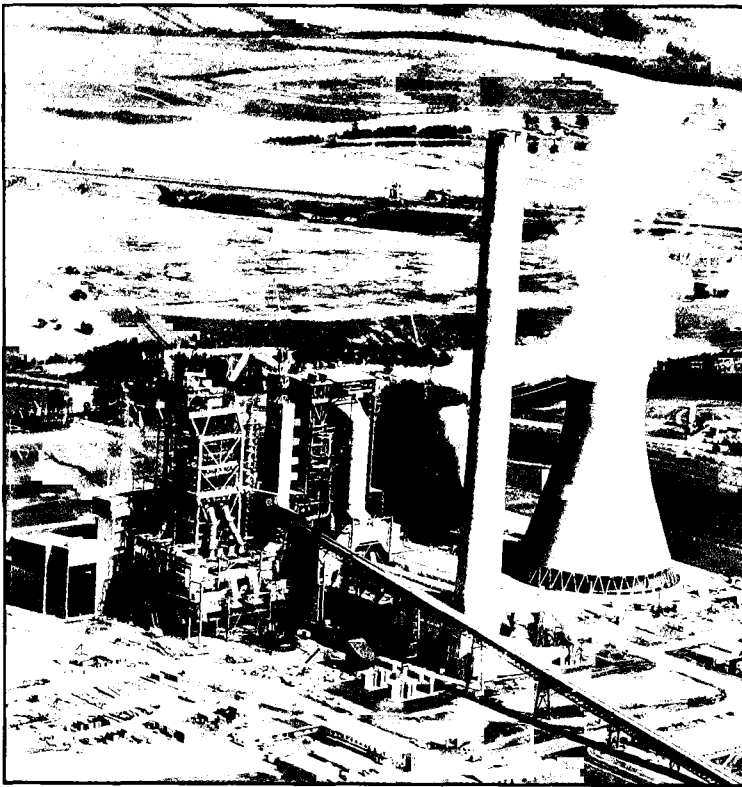
3.6.19 In addition, the SECV wanted to introduce *world best practices* in the operation and maintenance of its power stations. The SECV identified the need for structural change in its power generating sector if efficiency levels, similar to those regularly achieved in comparable operations elsewhere in the world, were to be realised. As a new power station situated in the Latrobe Valley, Loy Yang B provided an opportunity to create a competitive environment thereby improving current operating practices, which had restricted the performance of existing power stations. The SECV believed that the introduction of competition would have significant flow-on benefits in the operation of its other power stations in the Latrobe Valley.

3.6.20 By late 1990, the SECV's preferred financing option was to sell 100 per cent of the partially completed Loy Yang B to private sector interests. However, in April 1991, the Government determined that only a 40 per cent share of Loy Yang B would be sold to private enterprise, which would operate the power station. A 49 per cent holding in Loy Yang B was to be retained by the SECV and the State Government proposed to establish an investment organisation to hold the remaining 11 per cent.

3.6.21 In September 1991, the SECV distributed an information memorandum to various interested parties inviting bids for the purchase of Loy Yang B. The prospective purchasers were involved in a lengthy competitive bidding process prior to sole bidder status being awarded to Mission Energy in May 1992. On the basis of a valuation of Loy Yang B of \$1 295 million at the time, Mission Energy's 40 per cent share was valued at \$518.2 million to the SECV. Settlement of the sale was targeted for 30 June 1992.

Revised basis of sale

3.6.22 Audit was advised that in November 1992, following discussions between the Treasurer of Victoria, the Minister for Energy and Minerals and Mission Energy, the newly elected Government together with the SECV determined a revised basis for the sale of Loy Yang B. The revised basis involved the SECV retaining its 49 per cent share of Loy Yang B in a subsidiary company and Mission Energy purchasing the remaining 51 per cent, including the 11 per cent that was formerly to be allocated to the investment organisation that the Government was to establish.



Loy Yang B power station: unit 1 in operation, unit 2 under construction.

Settlement of the sale of Loy Yang B

3.6.23 On 31 December 1992, the SECV sold the partially completed Loy Yang B for \$1 016 million, compared with the earlier valuation of \$1 295 million. Proceeds from the sale were as follows:

- \$518.2 million from Mission Energy. This amount was used by the SECV to retire debt in accordance with the requirements of the *Loy Yang B Act 1992*; and
- \$497.8 million from LYBCO. The purchase was financed by way of a loan from the SECV.

3.6.24 In addition, the 2 parties paid \$61.4 million to the SECV as compensation for the delay in settlement between the intended sale date of 30 June 1992 and the settlement date of 31 December 1992. Mission Energy's portion of this amount was also used by the SECV to retire debt. Details of this apportionment are provided in later paragraphs.

3.6.25 Mission Energy obtained the 51 per cent share of Loy Yang B for the same price as it originally intended to pay for a 40 per cent share of the partly completed power station. The unchanged purchase price was justified by the SECV on the grounds that the purchase price for power produced by Loy Yang B was reduced, as detailed later in this Report.

Did the sale represent good value to the SECV?

3.6.26 Whether the sale of Loy Yang B was a financial success or not can be determined by a comparison of the sale price with:

- the actual construction costs incurred by the SECV up to the point of sale;
- its book value as recorded in the financial records of the SECV at the time of sale; and
- an economic analysis of the trade-off between the sale price of Loy Yang B and the price to be paid by the SECV for power generated by the power station.

Comparison of sale proceeds with Loy Yang B construction costs and book valuation

Construction costs

3.6.27 Construction costs incurred by the SECV up to the agreed date of valuation for the sale of Loy Yang B were \$1 418 million. **However, when Loy Yang B's construction costs are compared with the proceeds of \$1 016 million received for the sale, there is a deficiency of \$402 million, (see Table 3.6C) which will still be required to be serviced by the SECV by way of interest and principal repayments in the future.** However, this deficiency needs to be considered together with the benefits of the reduced power tariff negotiated at the same time and detailed in paragraph 3.6.30.

Book valuation

3.6.28 During 1991-92 the SECV adopted a new accounting policy for the valuation of non-current assets so as to comply with the revised provisions of Australian Accounting Standard, AAS10, *Accounting for the Revaluation of Non-Current Assets*. This standard requires that the reported value of non-current assets, such as power stations, is not to exceed the amount that can be expected to be recovered through its future use and subsequent disposal. Adoption of the revised standard necessitated a reassessment of the value of the SECV fixed assets. Between the date of the adoption of the revised accounting policy and the sale of Loy Yang B, 2 devaluations of the power station occurred: \$125 million in June 1992 and \$279 million in December 1992.

3.6.29 Following the abovementioned devaluations, the book value of Loy Yang B equalled the purchase price paid by Mission Energy and LYBCO and, in accounting terms, there was no resultant profit or loss on the transaction. Details are provided in Table 3.6C.

TABLE 3.6C
COMPARISON OF SALE PROCEEDS WITH
LOY YANG B CONSTRUCTION COSTS AND BOOK VALUATION
(\$million)

<i>Details</i>	<i>Based on construction costs</i>	<i>Based on book value</i>
Book value		(a) 1 420
Actual construction costs of Loy Yang B	(a) 1 418	
Less devaluation		125
Book value at 30 June 1992		1 295
Less further devaluation at 31 December 1992		279
Adjusted book value at 31 December 1992		1 016
Construction costs	1 418	
Less proceeds of sale -		
Mission Energy	518	(b) 518
LYBCO	498	498
	1 016	1 016
Accounting profit/loss		NIL
Cash deficiency	402	

(a) The difference of \$2 million between the book value and actual construction costs is attributable to the book valuation being an estimation of construction costs prior to the period ending 30 June 1992.

(b) Represents 40 per cent of book value at 30 June 1992 (\$1 295 million).

*Comparison of sale price with the long-term economic benefits
to be gained by the SECV over the useful life of Loy Yang B*

3.6.30 It should be appreciated that, while a comparison of cash receipts with cash outlays revealed a deficiency of \$402 million on the sale of Loy Yang B, the SECV had determined that the deficiency would be more than recouped through a reduced power tariff negotiated by the SECV. Table 3.6D below details the savings to be achieved from a reduction in the initial power tariff.

TABLE 3.6D
SAVINGS IN POWER TARIFF NEGOTIATED BETWEEN EACH DEVALUATION

<i>Selling price of station</i>	<i>Devaluation</i>	<i>Savings on original tariff</i>	<i>Cumulative savings</i>	<i>Savings on electricity purchase costs (a)</i>	<i>Cumulative savings (a)</i>
<i>(\$m)</i>	<i>(\$m)</i>	<i>(c per kwh)</i>	<i>(c per kwh)</i>	<i>(\$m)</i>	<i>(\$m)</i>
1 420	-	-	-	-	-
1 295	(125)	0.56	0.56	371	371
1 016	(279)	0.80	1.36	801	1 172

(a) Based on an operating life of the Loy Yang B power station of 33 years and in 1992-93 real dollars.

3.6.31 Based on the above calculations, the SECV's estimates indicate that the reduction in electricity purchase costs obtained in line with the reduced selling price of Loy Yang B will result in net savings of around \$770 million (cumulative savings of \$1 172 million on electricity purchases, less the deficiency on sale of \$402 million) to the SECV over the 33 years of the operating life of Loy Yang B.

□ **RESPONSE** provided by former Chief General Manager, State Electricity Commission of Victoria

The Commission considers that the only valid way to determine whether the sale was "good value" or not is to compare the sale price with the long-term economic benefits to be gained by the Commission over the useful life of the station.

Thus, the analysis in paragraphs 3.6.27 to 3.6.29 is only partial, and the real evaluation is contained in paragraphs 3.6.30 and 3.6.31.

The savings generated from lowering the power price are not estimates and are not sensitive to demand for electricity. The savings result from the permanent difference between the actual power price and the power price that would have applied if the sale price had remained at \$1 420 million.

This was subject to detailed economic analysis. Both the model and analysis were made available to the Auditor-General.

Costs associated with the sale of Loy Yang B

3.6.32 In addition to the \$402 million deficiency, the SECV and the State have incurred further direct costs in relation to the sale. Table 3.6E below illustrates the costs borne by the SECV and the Government

**TABLE 3.6E
COSTS ASSOCIATED WITH SALE OF LOY YANG B**

Costs	\$million
Commission's costs -	
Legal and other costs	23.2
Delayed settlement amount forgone	7.6
Stamp duty paid on behalf of Mission Energy	6.2
	37.0
Government's costs -	
Stamp duty forgone	49.7
Total costs	86.7

3.6.33 The costs of the delayed settlement and the stamp duty paid and forgone were taken into account in the negotiations for the reduction in electricity purchase costs. The following paragraphs provide detailed comments on the above costs.

Legal and other costs

3.6.34 Since the sale of Loy Yang B was first proposed in August 1990, the costs detailed in Table 3.6F have been incurred by the SECV

**TABLE 3.6F
COSTS INCURRED IN ARRANGING SALE OF STATION**

Costs	\$million
Legal	12.4
Financial/commercial	5.4
Loy Yang task force expenses	2.8
Other expenses	2.6
Total costs	23.2

3.6.35 The substantial legal costs paid to the SECV's legal advisor on the sale arrangement were largely related to the services in drawing-up the complex joint venture and ancillary agreements and the lengthy settlement process.

Delayed settlement amount forgone

3.6.36 As indicated previously, the SECV was successful in negotiating a delayed settlement agreement to compensate for the cost of the delay associated with finalising the sale. This sum was calculated as the additional financing cost and other expenses incurred by the SECV in continuing to hold the asset. Upon settlement, on 31 December 1992, the delayed settlement amount was calculated at \$69 million.

3.6.37 However, at the time Mission Energy increased its ownership interest in Loy Yang B to 51 per cent, there was already agreement between the Government and the SECV that Mission Energy would reimburse only 40 per cent of the delayed settlement amount. **As a consequence, the SECV was required to bear the balance of \$7.6 million.** Table 3.6G provides details of the apportioned delayed settlement amount.

TABLE 3.6G
APPORTIONMENT OF DELAYED SETTLEMENT AMOUNT

<i>Details</i>	<i>\$million</i>
Delayed settlement amount	69.0
LYBCO's share (49 per cent)	33.8
Mission Energy share (40 per cent)	27.6
Total paid	61.4
Balance (11 per cent) borne by SECV	7.6

Stamp duty rebate

3.6.38 When planning for the sale of Loy Yang B, the SECV reached agreement with the Government that the purchaser would, if possible, be granted a stamp duty concession.

3.6.39 The concession to be granted to the SECV was that it would pay stamp duty at the rate of only 1.2 per cent of the purchase price (the rate applicable to a lease transaction), rather than 5.5 per cent (the rate applicable to a sale transaction).

3.6.40 Prospective purchasers were informed that their bids should be made on the basis that stamp duty would not be payable. In the event that the State Revenue Office determined that stamp duty was payable, the purchaser retained the right to adjust the power price quoted in the bids for electricity to be supplied to the SECV.

3.6.41 The concession to be granted to LYBCO was that it would be exempt from stamp duty on the basis that the transaction would be categorised as a corporate restructure. Under the provisions of the *Stamp Duty Act 1958* actions arising from a corporate restructure are exempt from stamp duty.

3.6.42 Following numerous discussions between the State Revenue Office and the SECV, a determination was made that stamp duty of \$55.9 million, i.e. 5.5 per cent of the total sale price of \$1 016 million, was payable by the purchasers.

3.6.43 Given the additional costs imposed on the SECV of \$55.9 million, the Government agreed to make an ex-gratia payment of \$49.7 million so as to limit the stamp duty liability of the SECV. The effect of these transactions was that the net amount borne by the SECV was \$6.2 million, which equated to 1.2 per cent of the amount of \$518.2 million paid by Mission Energy for Loy Yang B.

3.6.44 The SECV advised audit that the amount of \$55.9 million had been taken into account when negotiating the revised power price. Although \$49.7 million had been provided by the State, the benefit, in the form of the reduced power price, will flow to the SECV. Details of the stamp duty paid are shown in Table 3.6H.

**TABLE 3.6H
DETAILS OF STAMP DUTY TRANSACTIONS**

<i>Details</i>	<i>\$million</i>
Stamp duty assessed and paid by the SECV at 5.5 per cent on sale price of \$1 016 million	\$55.9
Less ex-gratia payment by the Government	\$49.7
Stamp duty borne by the SECV(a)	\$6.2

(a) Equates to Mission Energy's 51 per share of the Loy Yang B, \$518.2 million, at 1.2 per cent.

3.6.45 The overall result of the above transaction is that:

- the SECV incurred additional expenses of \$6.2 million; and
- the State has accepted the cost of \$49.7 million which, in normal circumstances, would have been payable by the purchasers of Loy Yang B.

□ RESPONSE provided by former Chief General Manager, State Electricity Commission of Victoria

All reductions in the transaction cost of the Loy Yang B transaction (e.g. stamp duty reductions) were fully reflected in a reduced power price.

Additionally, the holding of 49 per cent of the asset by the Commission's subsidiary in the joint venture is a restructure, and government policy is for such restructuring to be exempt. Thus, it is incorrect to conclude that stamp duty on the 49 per cent share is revenue forgone.

Guarantees/assumption of risks

Introduction

3.6.46 Generally, the risks associated with the operation of Loy Yang B were allocated to each participant prior to any negotiations with prospective purchasers, on the basis of each party's ability to manage and control that risk. This action was taken by the SECV to ensure that the lowest possible cost of power was achieved

Guarantees by the Treasurer of Victoria

3.6.47 The *Loy Yang B Act 1992* prescribes that the Treasurer may give a guarantee in favour of, or enter into an agreement with, any person or body of persons in respect of the performance obligations required to be performed by:

- the SECV; or
- a body established by or under an Act for a public purpose; or
- a body all the shares in which are owned (directly or indirectly) by or on behalf of the State or the SECV, in connection with the project.

3.6.48 The Treasurer of Victoria has entered into a State Support Agreement under which the State provides security to procure the performance of obligations required to be fulfilled by the SECV under certain of the project contracts with Mission Energy and LYBCO. The project agreements to which this undertaking applies concern the SECV's obligations to complete construction of Loy Yang B, to purchase power, and to supply coal and certain services to the project. (The undertaking is not legally in the form of a guarantee, but has similar commercial effect to a guarantee.)

3.6.49 This undertaking by the State in favour of Mission Energy and LYBCO continues until certain specified criteria relating to the independent credit worthiness of the SECV are satisfied. If and when those criteria are satisfied and the undertaking is released, the participants will continue to be protected against certain actions by the State, such as industry restructuring, that affects the ability of the SECV to fulfil its contractual obligations. In the event that contractual obligations are not met, the State will be required to provide a substitute body which is able to perform the obligations or to reinstate the performance undertaking.

3.6.50 If a substitute body assumes the contractual obligations of the SECV, such as in the event of a restructuring of the electricity industry, the State's obligations under the State Support Agreement apply in the same way to the substitute body as they now apply to the SECV.

3.6.51 Mission Energy has charged its rights under the State Support Agreement in favour of its financiers as security for funds advanced to Mission Energy for the purchase of its share of Loy Yang B and to finance outstanding construction costs of the power station. While the credit facility (which has a term of up to 19 years) remains outstanding, Mission Energy may not agree to release the State's undertaking to procure performance of the SECV's obligations unless the financiers approve of the release. The financiers are included as parties to the State Support Agreement in order to regulate the terms on which they would be required to grant their approval to release the State's undertaking when the independent credit worthiness of the SECV is established.

3.6.52 This recourse to government support was seen to be an important security upon which financiers have provided funds to Mission Energy.

3.6.53 **In audit opinion, the effect of a Treasurer's guarantee to the SECV or similar body is that the participants to the project (Mission Energy, Mission Energy's financiers and LYBCO) are given a guarantee for contractual obligations that the SECV is required to perform, such as the purchase of power.**

Risks assumed by the respective parties to the transaction agreements

3.6.54 While audit does not doubt that the allocation of the major risks associated with the venture were the subject of intense negotiations between all interested parties to the contracts, including the Government, the SECV, Mission Energy and the financing bodies, the risks ultimately borne by the SECV reflect the problems involved in privatising a segment of a government-owned monopoly. These include:

- assuring investors and financiers of a market share in a monopolised market;
- guaranteeing a continued market position in the event of government restructuring of the monopolised electricity industry; and
- securing a supply of goods and services (such as coal and water), at competitive prices, especially when the supply is only available from the government monopoly.

3.6.55 The major risks assumed by the SECV and Mission Energy are:

<i>SECV's risks</i>	<i>Mission Energy's risks</i>
<ul style="list-style-type: none"> ▪ Market ▪ Construction ▪ Financing rate ▪ Energy tax 	<ul style="list-style-type: none"> ▪ Industrial relations ▪ Exchange rate ▪ Taxation rate ▪ Operating and maintenance ▪ Power station availability
<ul style="list-style-type: none"> ▪ Industry deregulation 	

3.6.56 Comments on the risks assumed by the SECV are detailed in the following paragraphs.

Market risk

3.6.57 The greatest risk borne by the SECV is the market risk associated with the supply and demand for electricity from Loy Yang B. Under the terms of the Power Supply Agreement (PSA) entered into with Mission Energy, the SECV is committed on a *take and pay when available* basis for 33 years to purchasing the power from Loy Yang B.

3.6.58 As a coal-fired power station, Loy Yang B has been designed and built by the SECV as a base load power station. Base load power stations are designed to meet the bulk of the State's minimum daily demand for power. Along with Loy Yang A, these base load power stations will operate continuously, supplying the Victorian grid with the lowest marginal cost of power available.

3.6.59 The SECV's payment for power under the PSA comprises 2 components, namely:

- *Capability charge:* The capability charge covers the fixed costs of ownership of the Loy Yang B power station before allowing for variable costs incurred in its operation. **The payment of this charge is dependent upon the capability of Loy Yang B to produce power irrespective of the actual amount of power taken by the SECV.** The capability charge is intended to cover the projected fixed costs of operating Loy Yang B, including debt servicing, with any balance providing equity returns. It is expected that 85 per cent of all payments to Loy Yang B will fall into this category; and
- *Energy charge:* The energy charge covers the variable costs of actually generating a unit of energy, such as the cost of coal and water used.

3.6.60 The risk to the SECV related to the *take and pay when available* provision is that it may have to pay a capability charge for power that is not produced and not required. When one considers that the purchase of power under the PSA has been entered into for a period in excess of 30 years, there must be a risk that Commission forecasts may vary. This risk would be further compounded if:

- the discovery of cheaper alternative methods of electricity production and generation is made within the next 33 years;
- the Victorian power price is found not to be competitive in comparison with prices charged by interstate power bodies when the national grid commences operations; and
- environmental restrictions are placed on coal-fired power stations in the future because of their high carbon dioxide emissions.

3.6.61 Audit acknowledges that the SECV undertook detailed forecasts of the future demand for and cost of electricity in negotiating an acceptable selling price for Loy Yang B and power tariff for its output. However, it must be kept in mind that the risks of not achieving those forecasts are greatly compounded the further into the future those forecasts are made. Indeed, the SECV's forecasts for future electricity demand in the 1970s proved to be over optimistic when reviewed in the mid-1980s. This review led to a substantial downgrading in the size of Loy Yang B from a 2 000 megawatt to a 1 000 megawatt power station.

Construction risk

3.6.62 Under a Completion of Construction Agreement, the SECV assumes the role of head contractor for the completion of Loy Yang B on the basis of a fixed price, fixed date contract for approximately \$800 million. If final construction costs exceed the contract amount, the SECV will bear the additional cost. On the other hand, if construction costs are less than the contract amount, the SECV will realise a profit.

3.6.63 In the event that the Commission fails to meet the construction and handover deadlines, Mission Energy can claim compensation for delays from the SECV. The SECV may be able to recoup any costs by suing its sub-contractors.

Financing risk

3.6.64 Mission Energy's borrowings have been taken out at variable interest rates. Any upward or downward fluctuations in the interest rate will be reflected in the capability charge payable by the SECV. To minimise the risk of an increase in the capability charge due to any upward movement in interest rates over the next 10 years, the SECV has hedged, by way of interest rate swaps, its power price. Such action by the SECV has allowed it to lock in the electricity tariff over this period.

Energy tax risk

3.6.65 The SECV has undertaken to pay any special energy or pollution tax which may be imposed in the future by allowing such charges to be passed on through the pricing structure determined under the PSA.

Industry deregulation risk

3.6.66 Mission Energy requested protection from the State in the event that the SECV is disaggregated or completely privatised. This protection was sought by Mission Energy's financiers as they required security over the continual purchase of the power generated by Loy Yang B. The State has assured Mission Energy and its financiers through the State Support Agreement, that in the event of any split up or privatisation of the SECV, a State-owned body will be established, with sufficient funds to purchase the Loy Yang B output for the remaining life of the project.

3.6.67 The SECV can also buyout Mission Energy if as a result of industry deregulation the structure of the electricity industry is so fundamentally changed that the PSA is no longer appropriate.

□ RESPONSE provided by former Chief General Manager, State Electricity Commission of Victoria

Much of what is said in the section on risks assumed by the parties is speculative, based on what might have been "if a more open and competitive electricity market was in existence".

It must be recognised that all the risks enumerated in this section would have remained with the Commission if the sale had not taken place. All these risks arose when the Government and the Commission took the decision to build the power station in 1985. The Commission did not assume additional risks as a result of the sale; it retained those risks which the Report rightly notes were based on ability "to manage and control that risk".

Conclusion

3.6.68 The sale of Loy Yang B power station has allowed the SECV to:

- Attract an operator with international experience to operate Loy Yang B;
- Alleviate its exposure to the high level of debt funding; and
- Introduce competitive benchmarking in the operation of a large power station with the expectation of enhanced efficiencies in the management of the other power stations operated by the SECV. As identified in the Auditor-General's *Special Report No. 24, Open Cut Production in the Latrobe Valley*, reference was made to the fact that the introduction of private competition in the removal of overburden at the Morwell open cut led to substantial productivity improvements by SECV employees.

3.6.69 However, the abovementioned benefits have not been achieved without cost. Specifically, the SECV has:

- Locked itself into a long-term *take and pay when available* contract for the power generated by Loy Yang B, which in audit opinion effectively erodes the anticipated benefits from the introduction of competition.

The Report of the Victorian Commission of Audit released in May 1993, stated that the entering into take or pay arrangements were "... of considerable concern to the Commission [of Audit] because by locking the enterprises concerned into a particular set of arrangements to apply for many years into the future, they may limit the benefits to the Victorian community. They may also reduce flexibility and complicate enterprise or industry restructuring".

Commenting specifically on the long-term contract entered into by the SECV for the purchase of power from Loy Yang B, the Commission of Audit stated "... it is unlikely that such agreements maximise the value of Government Business Enterprises to the State in the event of sale and they do little directly to improve efficiency through providing a competitive focus or improving market contestability, although the introduction of new management expertise may provide a benchmark for other power stations owned by the SECV".

Overall, the Commission of Audit recommended that such arrangements extending over many years should be avoided;

- Sold Loy Yang B for substantially less than its construction costs and incurred substantial expenses in arranging the sale and negotiating the very complex commercial and legal structures of the transaction, in return for a lower power tariff; and

- Entered into agreements where it is exposed to a number of risks that might have been transferred to the private sector if the electricity generation industry was structured in a more competitive and open basis.

The Victorian Commission of Audit, commenting on financial risk and risk sharing arrangements flowing from asset sales recommended that "... asset sales should only be contemplated and executed on a 'no strings' basis." And that "... Government Business Enterprises need to ensure arrangements are transparent and entail an appropriate sharing of risks (as well as benefits). It is more appropriate that private operators recover costs through direct user charges rather than through leasing arrangements or 'take or pay' contracts with government".

3.6.70 On the other hand, Mission Energy has gained substantial benefits by establishing a foothold in the Australian electricity industry, obtaining State guarantees for the SECV's payment obligations and securing a guaranteed contract for the sale of Loy Yang B's output in excess of 30 years.

3.6.71 It is difficult to gauge the benefits of privatisation in this instance where competition is injected into a monopoly industry by the discounting of the asset sold, the SECV assuming some of the risks that could normally be transferred in a truly competitive electricity market and by the availability of government guarantees for contractual obligations which the SECV is required to perform.

□ **RESPONSE** provided by former Chief General Manager, State Electricity Commission of Victoria

The Commission has no additional comments on the conclusions. The points made above in relation to the proceeds of sale and the related power tariff trade-off and the allocation of risks are equally relevant to the conclusions, i.e. risk was retained rather than assumed, and the sale price was reduced but only in exchange for economically favourable long-term power prices.

I believe it is important to reiterate that the Commission has led the electricity supply industry reforms currently underway in Victoria and in Australia. The part sale of Loy Yang B was a major factor in the reform process and has produced significant flow-on benefits in other parts of the Commission's operations.

REFORM OF VICTORIA'S ELECTRICITY SUPPLY INDUSTRY

Introduction

3.6.72 The SECV was, at 30 June 1993, one of the largest public sector organisations in Australia employing some 12 000 people.

3.6.73 In August 1993, the Government announced a major reform program for the electricity supply industry which involved the disaggregation of the SECV into 3 new State-owned bodies, each respectively responsible for the generation, transmission and distribution of electricity. This announcement foreshadowed the start of the State Government's major reform program for the electricity supply industry (ESI) in Victoria. The Government considered that the restructuring of the industry would improve its competitiveness and efficiency and lead to an improvement in the State's economy.

Reform of the electricity industry

3.6.74 The reform of the Victorian electricity supply industry complements the wider reforms involving the Commonwealth Government, Queensland, New South Wales, Victoria, Tasmania and South Australia entering into arrangements for the formation and operation of a national power grid.

National power grid

3.6.75 The Commonwealth Industry Commission's report into the electricity industry released in May 1991 was adopted by the Commonwealth Government in January 1992. The Industry Commission recommended a staged but radical restructuring of the electricity industry to increase competition which would involve:

- separation of ownership of generation, transmission and distribution functions;
- corporatisation of those functions so that all entities operate on a commercial basis at arms-length from government;
- the establishment of a national grid network for the interstate trading of power between the participating States; and
- the sale of all generation and distribution assets to the private sector.

3.6.76 The move towards the industry restructure has been facilitated through the National Grid Management Council and the Council of Australian Governments. Initiatives to date include:

- the operation on a trial basis of a customer wholesale market for electricity covering the participating States which began in November 1993;
- an agreement to establish, by July 1995, a fully competitive electricity market and multiple network corporations based on interstate transmission grids; and
- a commitment by all States to the separation of generation from transmission and distribution.

Victoria's reform

3.6.77 In August 1992, the State Government announced plans to review and reform government trading enterprises, including the State's electricity supply industry. The Treasurer stated at the time *"A more efficient, competitive electricity industry will, in the long-term, mean lower tariffs, improved services and a stronger position for Victoria in the emerging national electricity market"*.

3.6.78 The need to reform the State's electricity industry was seen as necessary due to the relatively costly, inefficient and unresponsive nature of the existing SECV's operations. Factors which contributed to this were:

- over capacity in the present generation system due to excessive capital spending and over-design of facilities;
- an unfair tariff structure which overcharges some customer groups and subsidises others;
- no independent regulation of pricing or supply quality; and
- a lack of competitive pressure to stimulate innovation, commercial investment decisions, world standard productivity and maximise value for customers.

3.6.79 The Electricity Supply Industry Reform Unit (ESIRU) was established in mid-October 1993 to advise government on further ESI reform. The initial task was to undertake a rigorous analysis of ESI reforms to date and to develop appropriate recommendations for government. The Government expects the reform process to take 6 years to be completed. Comments on reforms instituted to date are detailed below.

Reform process: Stage 1

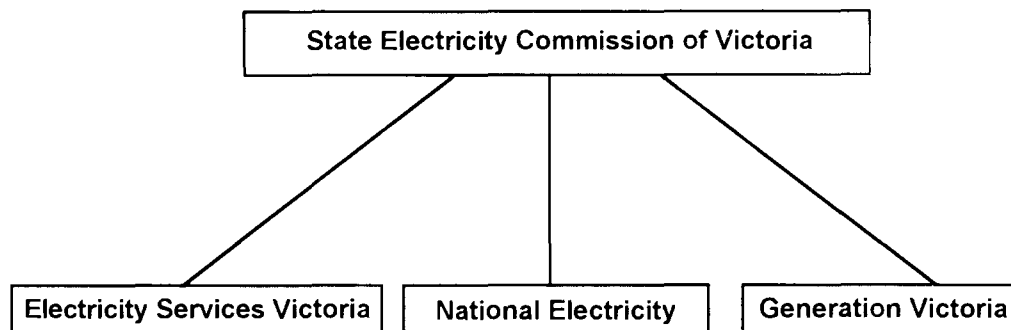
3.6.80 In October 1993 the SECV was separated into 3 State-owned bodies established under the *State Owned Enterprises Act 1993*, namely National Electricity, Electricity Services Victoria and Generation Victoria.

3.6.81 These bodies have the following responsibilities:

- National Electricity is responsible for the high voltage transmission of power from the power stations to the distribution network and directly connected customers and the operation of system security and the electricity pool;
- Electricity Services Victoria operates the bulk of the low voltage distribution network in the State and supplies electricity at the retail level; and
- Generation Victoria operates the brown coal mines, thermal, gas and hydro power stations and associated facilities.

3.6.82 Chart 3.6I illustrates the revised structure of the electricity industry from October 1993.

CHART 3.6I
STRUCTURE OF THE VICTORIAN ELECTRICITY INDUSTRY, OCTOBER 1993



3.6.83 The State Electricity Commission of Victoria remains as a "shell" and will retain some of the functions that cannot be readily allocated to the new corporations such as the management of head office accommodation and the completion of construction contracts for Loy Yang B.

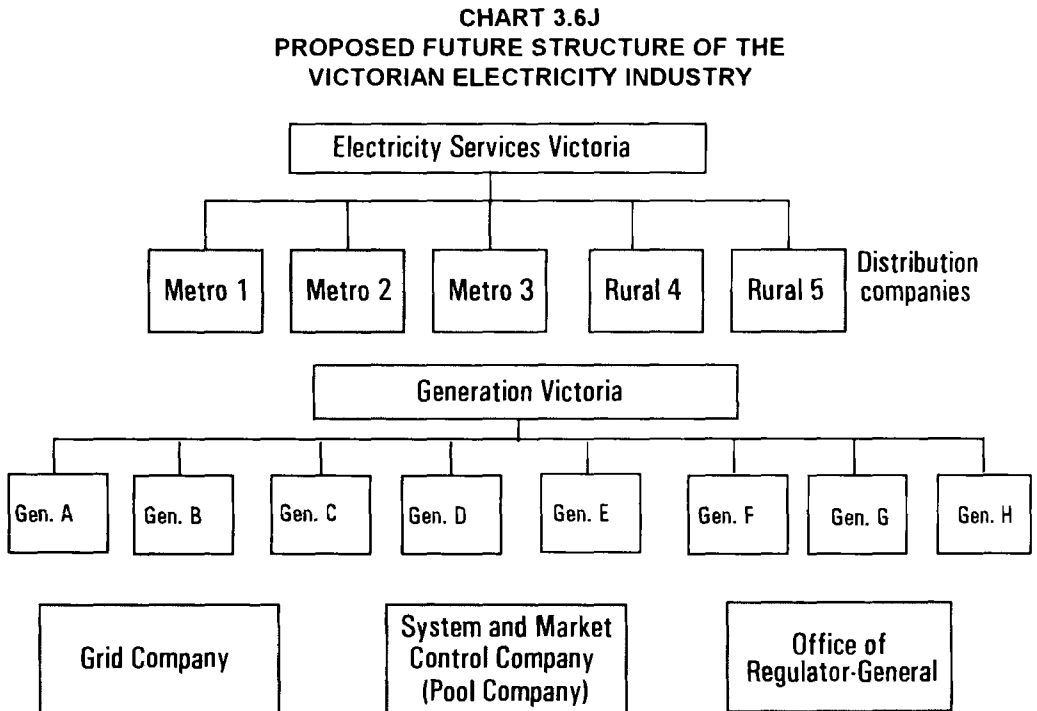
Reform process: Stage 2

3.6.84 Stage 2 of the reform process will involve the further disaggregation of Electricity Services Victoria and the establishment of 2 additional corporations, to bring to 9 the number of independent electricity entities on a date to be proclaimed, as follows:

- Electricity Services Victoria will cease to exist and will be divided into 5 regionally-based distribution companies, with 3 covering metropolitan Melbourne and 2 servicing rural Victoria;
- A Grid Company will own, maintain and manage the high voltage power grid. The network is regarded by the Government as a natural monopoly and will remain State-owned;
- Generation Victoria will remain. However, as an interim measure, it will be restructured into 8 independent business units which will trade separately in the market on a trial basis for 12 months;

- An independent system and market control company will be established as a statutory corporation, ultimately to be owned by the generation and distribution companies, to be known as the Pool Company, to monitor and control the wholesale electricity market and ensure security of the supply system; and
- The Government will establish the Office of Regulator-General to create an economic regulatory framework for regulated industries which promotes and safeguards competition and fair and efficient market conduct or, in the absence of a competitive market, which promotes the simulation of competitive market conduct and the prevention of the misuse of monopoly power.

3.6.85 At the completion of the above process the proposed revised structure of the electricity industry will be as shown in Chart 3.6J.



Overseas experience

3.6.86 There is general recognition of the need for a fundamental and significant change in the provision of electricity to consumers not only in Victoria but also Australia. However, with any process of change, it is the management of such change that determines the success or otherwise of the initiatives embarked upon, and ultimately the benefits that flow to the taxpayer.

3.6.87 Countries such as England and Wales, which have embarked on corporatisation and privatisation of their electricity industries, have experienced a number of pitfalls which have resulted in expensive and irreversible consequences to be borne by the community.

3.6.88 While audit acknowledges that the Government is aware of the problems encountered overseas, experience suggests that any implementation of change requires a sound conceptual framework, which includes a coherent policy of regulations and guidelines to ensure a smooth transition to the new structure. Liaison with the ESIRU disclosed that a comprehensive review process has been adopted, the outworking of which is a structural regulatory framework designed to overcome difficulties experienced in other jurisdictions. **Problems experienced overseas and measures proposed by the ESIRU and the Government to deal with these issues are outlined below:**

- *Political expediency.* Unlike some major policy shifts, which normally involve the calling of public hearings and submissions for deliberation by governments and the presentation of cost-benefit analyses of options, disaggregation and privatisation of ESI overseas have been based upon a theoretical model with no demonstrable analysis of exactly how the community would be better served.

The ESIRU has undertaken extensive work in regard to the most efficient and competitive structure for the ESI. The engagement of consultants, both locally and internationally based, and a process of regular independent critiques of consultant reports seeks to ensure that the final structure of the ESI is of optimum benefit to all Victorians.

- *Captive customers.* Unlike large corporations which have access to alternative suppliers and pricing structures, domestic consumers have had limited opportunities to benefit from the introduction of competition.

The regulatory regime recommended by the ESIRU and which is currently before Parliament, has the effect of regulating maximum uniform tariffs so that *captive* or *franchise* customers are guaranteed that the price they pay for the supply and sale of electricity is capped. In addition, Cabinet has approved a timetable which anticipates total deregulation of the domestic consumer markets by the year 2000.

- *Poor investment planning.* A potential consequence of competition is that investment by generator and distribution entities may not be co-ordinated, resulting in excess generation capacities and increased costs of distribution.

The ESIRU has proposed that this concern be addressed by introducing competitive disciplines to those sectors of the industry that are susceptible to competition and by regulating those sections that are not. In addition, a new entity, whose functions include operating and administering the market for wholesale trading in electricity and controlling the security of the electricity supply system, will be established.

- *Monopoly power.* The disaggregation of the ESI should not allow collusion between any industry players or be conducive to the exercise of monopoly power. To guard against the misuse of power by monopoly providers, overseas administrations have been forced to create regulating bodies to monitor the disaggregated/privatised electricity industry.

As previously mentioned, the Government has introduced legislation to establish an Office of the Regulator-General to:

- promote competitive market conduct; and
- prevent misuse of monopoly or market power.

□ *RESPONSE* provided by Project Leader, ESIRU

After a transitional period of regulation by the Regulator-General, the Commonwealth Trade Practices Act may replace certain State regulations to prohibit any anti-competitive conduct. This position is consistent with the recommendations of the Hilmer Report on a National Competition Policy.

- *Price rises.* As a result of poor investment planning, lack of public accountability and limited authority by governments over pricing policies, all classes of users, particularly captive domestic users, have experienced real price rises above inflation in power tariffs.

□ *RESPONSE* provided by Project Leader, ESIRU

The reform process will make the ESI significantly more efficient. Some of the benefits of the reform process can be made available by way of reduced prices. The regulatory regime governing the ESI will operate to ensure that customers as a whole, and in particular domestic consumers, experience initial real price decreases as a result of the reform process. Prices may increase again after the year 2000 as a reflection of the cost of new generation plant required. In particular, the capacity of the Regulator-General to set uniform tariffs for domestic consumers supports this proposition.

3.6.89 In addition to the experiences and actions being taken by government as detailed above, audit considers the following major issues also need addressing:

- Because National Electricity owns 49 per cent of Loy Yang B and is also the electricity pool operator, there may be a vested interest in the corporation purchasing electricity from Loy Yang B to the disadvantage of other competing generators.

Audit understands, however, that legislation before Parliament proposes that the Grid and Pool Companies will have no commercial interest in Loy Yang B.

- Agreements entered into by the State with Mission Energy and its financiers in respect of Mission Energy's 51 per cent ownership of Loy Yang B, exempt the owners of the power station from various legislation regulating competition and industry practices, such as the Trade Practices Act and Planning and Environment Act. As all future participants in the electricity supply industry will be subject to the provisions of the abovementioned statutes, clarification is needed on whether the application of the statutes will require re-negotiation of the agreements with Mission Energy.
- The Auditor-General's *Special Report No. 24, Open Cut Production in the Latrobe Valley* disclosed that the failure by the SECV to undertake timely rehabilitation of the power stations' open cut mines will require expenditure of \$125 million over the next 20 years. The basis of valuation for the sale of power stations to private interest will require careful consideration of any compensation for this rehabilitation. Audit considers that provision for the cost of rehabilitation should be disclosed in the financial statements of Generation Victoria.

□ *RESPONSE* provided by Project Leader, ESIRU

The sale value of power stations or the term of any sale contract will reflect normal commercial principles including any provision for rehabilitation expenditure, to the extent that this is quantifiable in the financial statements of the generator or as a contingent liability.

- Action needs to be taken to retain key personnel to ensure the new corporations are not totally dependent on external parties for strategic advice.

□ *RESPONSE provided by Project Leader. ESIRU*

The recruitment of senior management for the new companies that will constitute the new industry has already begun and the process adopted ensures that current industry personnel are considered for all positions.

- The extent to which financial and operational reporting across the industry will be standardised, to allow for valid comparisons of operations and performance between competing entities, needs to be considered.

□ *RESPONSE provided by Project Leader. ESIRU*

The new entities will have reporting obligations to the Regulator-General, one of the purposes of which is to allow the Regulator-General to benchmark the performance of entities against each other.

- The transfer of assets and liabilities to the new corporations will need to be assigned on an equitable basis.

□ *RESPONSE provided by Project Leader. ESIRU*

The value at which assets and liabilities (including debt) are transferred will be determined on an equitable basis to ensure appropriately capitalised corporations. The assignment of assets and liabilities will not be driven by a sale imperative. If this were so, the value to the State of the relevant assets would be undermined.

- Responsibility for the provision of community service obligations, such as the safety awareness programs, needs to be determined.
- In light of the cost to the SECV of the disastrous Ash Wednesday fires of 1983, the responsibility for State-wide fire mitigation needs to be clearly assigned.

3.6.90 While the Government is factoring overseas experiences into the reform process, it is also important that the Government systematically monitors the actual efficiency gains arising from the restructuring and privatisation of the electricity supply industry.

□ *RESPONSE provided by Project Leader. ESIRU*

Monitoring: Weaknesses have occurred both in Victoria and overseas when government corporatises State-owned enterprises and then fails to manage their subsequent performance. The proposals under consideration for ESI corporatised companies involve the production of a statement of corporate intent and business plan agreed at the beginning of the financial year and reported on a quarterly basis. This is to be supplemented with monthly statistics reported by the Board to the shareholder. The ESIRU recommends the appointment of an observer to each Board who is contracted specifically for the task and who has proven commercial skills. The observer should provide independent advice to the shareholder to support statistical and other reporting.

OUTSOURCING OF CERTAIN ACTIVITIES

Background

3.6.91 The Federal Government's national micro-economic reform agenda to deregulate the electricity industry through the introduction of a national grid will effectively remove the protected monopoly position of the States' electricity utilities and is intended to improve Australia's international trade competitiveness by providing industry with infrastructure services at world best practices price levels. Effectively this means that traditionally captive markets will be opened to full competition and, in Victoria, the SECV's monopoly position for electricity production and supply will be challenged by other States.

3.6.92 Until recently, the SECV had enjoyed a virtual monopoly over brown coal mining and power generation, transmission and distribution within Victoria. It supplies in excess of 1.9 million customers and has a power generation capacity of 7 763 megawatts and an annual revenue of \$4 billion.

3.6.93 The SECV, like other Australian electricity generators, is currently operating in a climate of significant change. This change has arisen from the need to become more efficient and competitive in line with State and federal strategies for the economy generally, and the electricity industry specifically.

3.6.94 As early as 1989, the SECV had recognised the need to ensure its long-term viability and undertook various studies with the objectives of determining the most appropriate cost structure to improve its business performance in order to ensure it remained competitive within the power industry.

3.6.95 To achieve the above objectives, the SECV embarked on a program of organisational change aimed at reducing costs by increasing productivity through changed work practices and decreasing the size of its workforce.

3.6.96 Although SECV staff numbers decreased from 21 551 to 15 870, in the 2 year period June 1989 to June 1991, its cost structure remained high as inefficient work practices such as demarcation issues, excessive staffing levels, under-utilisation of staff between plant outages and overruns on plant maintenance outages were not eliminated, and many of the non-core businesses continued to produce uneconomic results.

3.6.97 Later in 1991, the SECV embarked on a further program of organisational change, the major driving force again being the determination to improve its long-term competitive position. In view of the limited success of the earlier attempts by the SECV in achieving cost reductions, the decision was made to focus on core activities and close, sell or outsource any uneconomic or inefficient functions, with a strong preference for outsourcing.

3.6.98 The Government clearly identified the need for restructuring the industry in its Energy Policy released in 1992. The Policy stated that the monopolistic structure of the SECV had discouraged the efficient use of resources and inhibited the introduction of productivity improvements, including better employee/employer relations and the elimination of outdated work practices. The Policy outlined objectives which would significantly affect the operations of the SECV, including:

- the implementation of structural changes to maximise competition, efficiency, cost-effectiveness and debt reduction;
- the removal of monopolies; and
- the contracting out or sale of non-core functions.

3.6.99 In March 1993 the Government engaged a team of consultants to identify and advise on the optimal competitive structure for Victoria's Electricity Supply Industry (ESI). The ESI review concentrated on 3 key areas, namely power generation, electricity distribution and transmission grid.

3.6.100 The consultants' report indicated there was considerable scope to introduce competition to Victoria's ESI. It recommended a separation of the industry into electricity generators, distributors and retailers to allow competition within sectors which are not natural monopolies. The major benefits anticipated by the consultants from the reform process were increased competition and efficiencies, enhanced customer service, privatisation and debt reduction.

3.6.101 Following the recommendations of the ESI review, the Government introduced the *Electricity Industry Act* 1993 which provided for the restructuring of the industry by establishing 3 new electricity corporations and vesting the generation, transmission and distribution functions in each respectively. These corporations are Generation Victoria, National Electricity and Electricity Services Victoria.

3.6.102 This section of the Report provides comments on outsourcing activities undertaken by the SECV in the period February 1991 to November 1993, **prior** to the creation of the 3 new electricity corporations. The majority of outsourcing was undertaken in 1993 when the SECV was divided into 3 strategic business units, namely the Production, Power Grid and Customer Services Groups. The outsourcing contracts entered into by these Groups prior to the restructure will be taken over by the new corporations and will obviously impact on their future operations.

What is outsourcing?

3.6.103 Outsourcing is the contracting-out to the private sector of non-core services or functions and support activities previously performed by the use of internal resources, with the aim of improving the efficiency, effectiveness and economy of overall operations.

What has been the extent of outsourcing at the SECV?

3.6.104 In the period February 1991 to November 1993, the value of outsourcing contracts in excess of \$1 million entered into by the SECV was \$554 million. Details of contracts entered into during the above period by the 3 Groups within the SECV are shown in Table K.

TABLE 3.6K
VALUE OF SECV
OUTSOURCING CONTRACTS,
FEBRUARY 1991 TO NOVEMBER 1993

<i>Strategic business unit</i>	<i>\$million</i>
Production Group	442
Power Grid Group	83
Customer Services Group	29
Total	554

3.6.105 As indicated in the above table, outsourcing within the SECV has been a significant strategy used by management in achieving more efficient and effective operations. **In Victoria, the SECV has been at the forefront in reviewing its operations and determining which functions could be performed more efficiently of contractors.**

3.6.106 During 1993, audit undertook a review of the management of the SECV outsourcing activities to determine whether they were conducted in an economic, efficient and effective manner.

OVERALL CONCLUSION

3.6.107 Faced with the need to improve its long-term competitive position, in early 1991 the SECV embarked on an outsourcing program designed to reduce costs and improve productivity.

3.6.108 The outsourcing program has been extensive in size and has been undertaken in a relatively short time. Over the period February 1991 to November 1993, the SECV outsourced in excess of 34 activities involving contracts totalling \$554 million.

3.6.109 The SECV considers that overall, the outsourcing arrangements have been successful and have achieved the major objective of reducing costs, mainly by a reduction in staff numbers and productivity improvements.

3.6.110 The audit review has, in some respects, confirmed the SECV view of the benefits realised to date from outsourcing. There is little doubt that substantial gains have been achieved, particularly in relation to the reduction in staff numbers. Of importance has also been the fact that outsourcing has been implemented with a minimum of industrial unrest, in an industry which has, in the past, been subjected to considerable industrial pressure.

3.6.111 The examination of a number of outsourcing arrangements entered into by the SECV identified areas where the process could have been better managed and where there is scope for improving future arrangements. Specifically, audit found that:

- The SECV Board's involvement in the outsourcing process was limited notwithstanding the magnitude of the outsourcing arrangements entered into and the fact that the SECV was the pioneer in Victoria in entering into such extensive contractual arrangements. The Board issued outsourcing guidelines and ultimately approved the contracts entered into by the Groups, but had limited involvement in other phases of the process;
- In relation to the outsourcing arrangements reviewed by audit, the majority of the businesses involved were not adequately analysed, therefore audit was unable to determine whether these decisions were soundly based;
- The Groups did not formally document quantifiable objectives and targets to enable the performance of contractors to be measured;
- In some instances the best possible outsourcing arrangements may not have been obtained by the SECV, particularly where insufficient time was given to prospective contractors to submit Registrations of Interest and Tenders, or the open market was not accessed;
- Contractual arrangements entered into have on occasions provided substantial financial incentives to the contractors, such as payment for future voluntary departure packages for ex-SECV employees, compensation for idle resources, provision of minimum work guarantees and payments for mobilisation and demobilisation costs, to ensure that the outsourcing process was not jeopardised;

OVERALL CONCLUSION - *continued*

- The Groups have not established systems and procedures to monitor the outcome of various outsourcing arrangements and to report on these arrangements to the Board and the Parliament; and
- Costs associated with surplus employees who have not been able to be successfully redeployed within the SECV continue to have an adverse financial impact on the projected benefits from outsourcing.

3.6.112 As the outsourcing process is a recent government initiative, there is an opportunity for the issues and outcomes to be communicated between the new corporations as well as other public sector agencies contemplating or already pursuing outsourcing arrangements. This will ensure that the lessons learned and the knowledge gained by the SECV Groups are shared across the entire public sector and potential pitfalls are avoided.

□ *RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993*

The SECV Board was at all times well aware of the extent, size and scope of outsourcing.

The SECV Board issued a policy on outsourcing before outsourcing commenced, received regular progress reports and authorised all proposals on their way to the Minister.

The businesses that were outsourced were adequately analysed and reviewed. Considerable efforts, over the preceding 4 years, were made to improve productivity and business profitability and only when these actions failed was the outsourcing decision taken.

Sufficient time was allowed to prospective contractors to submit Registrations of Interest and tenders. The SECV followed all the published rules and guidelines available at the time.

No incentives were offered to contractors as a part of the outsourcing arrangements.

Systems and procedures to monitor outsourcing arrangements were not in place at the time of contract placement. However, the contracts have just been let and are subject to full reporting, audit and review now that they are operative

Key elements of the framework for identifying opportunities for, and managing, outsourced activities

3.6.113 Given the strategic impact on the core operations of the SECV of the activities to be outsourced, a framework was established to implement and manage the outsourcing process.

3.6.114 In October 1991, the Board of the SECV issued a key policy document entitled *Code of Practice - Outsourcing Process* to provide guidance to the Groups undertaking outsourcing activities. Other documents previously issued by the Board were also available to assist in the outsourcing process. These included the *Purchasing Policy and Procedures* manual and the *Economic Evaluation of Expenditure Proposals* guidelines.

3.6.115 In May 1993 the Office of State Owned Enterprises, which was established to regulate the constitution and relationship with the Government of State-owned enterprises, prepared guidelines to assist public sector organisations in managing the contracting-out process. By this stage the Groups were well advanced in negotiating their outsourcing arrangements.

3.6.116 Broadly, both sets of guidelines provide criteria for:

- identifying contracting-out opportunities;
- evaluating such contracting-out opportunities;
- undertaking the tender process; and
- monitoring and evaluating the outsourced activity.

Overall strategic planning and management

Identification and prioritisation of potential outsourcing activities

3.6.117 Understanding the organisation and its goals and objectives is an important element in identifying the activities which may be suitable for outsourcing. The process of outsourcing requires an appreciation of an organisation's strengths and weaknesses and the environment in which it operates.

3.6.118 An organisation needs to determine the strategic and operational goals that should be reflected in its policies and business plans. Each business unit should be provided with proper direction and clearly defined objectives expected from the outsourcing process to ensure the organisation's strategies, goals and objectives are achieved in a planned and co-ordinated manner.

3.6.119 In addition, involvement by the Board and executive management in the identification, prioritisation and confirmation of potential outsourcing opportunities is essential to ensure:

- accountability for decisions made,
- the organisation is operating at optimum capacity and efficiency; and
- the decisions are consistent with the organisation's overall corporate strategy

3.6.120 In 1993, the SECV prepared a formal 3 year business plan outlining its operations and business strategies. The plan was driven by the goal of achieving world best practice service levels, operational targets and business results. In implementing the plan, the Groups considered outsourcing to be the only practical means of achieving the necessary results.

3.6.121 To assess the degree of outsourcing to be undertaken, all Groups carried out studies and benchmarking exercises and in some instances sought the assistance of external consultants in this process.

3.6.122 The benchmarking exercise undertaken by the Production Group covered only a limited number of businesses of the Group. Notwithstanding this limited review, the General Manager of the Production Group decided that all non-profitable businesses of the Group were to be outsourced on the assumption that efficiencies could automatically be achieved. This assumption was contrary to the SECV guidelines on outsourcing which required that the tendering process should only be proceeded with if a review of the existing service or function demonstrated an economic advantage to the SECV by outsourcing. Nevertheless, the Group proceeded to seek Registrations of Interest from prospective tenderers.

3.6.123 The Production Group's decision to outsource based on a limited sample of businesses within the Group, casts doubt, in audit opinion, on the validity of the decision as each business recording losses was not analysed in a detailed manner taking into consideration all factors necessary such as preparing cost-benefit analyses and evaluating the reasons for apparent excessive costs of operation, along with internal options available to reduce costs.

3.6.124 Key strategy documents including the time frame for outsourcing individual businesses were not forwarded by the Groups to the SECV Board. While progress reports in respect of these activities were presented to the Board there was no documentary evidence available to indicate that these reports were presented on a regular basis.

3.6.125 Although the strategies adopted by each of the Groups may eventually result in increased competitiveness, the audit of the respective outsourcing strategies revealed:

- the Board did not provide formal direction to the Groups outlining the key strategies, goals and objectives for outsourcing;
- no clear definition of core and non-core functions was provided by the Board to the Groups to determine the outsourcing boundaries;
- the Board did not confirm the Groups' strengths, weaknesses, opportunities and threats in respect of outsourcing particular activities; and
- the timeframes for the outsourcing of individual businesses developed by some Groups were not approved by the Board nor were the businesses to be outsourced prioritised.

3.6.126 As the Board had overall responsibility for the operations of the SECV, audit considers that it should have been:

- more involved in the various stages of the outsourcing arrangements, given that arrangements were new and of considerable financial magnitude; and
- provided with regular reports on the status of the Groups' outsourcing activities for review and endorsement.

3.6.127 **Members of the Boards of the 3 newly established corporations should review the procedures for approving and monitoring future outsourcing arrangements to ensure adequate control is exercised and that their duties as Board members are properly discharged.**

□ *RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993*

The intent of the audit recommendation is clear, however, given the transient nature of the 3 new corporations, it is likely that any further substantial outsourcing will be undertaken by different organisations.

Co-ordination, control and communication of outsourcing process

3.6.128 With the commencement of the SECV's major outsourcing program in 1991, each Group took on the responsibility for outsourcing activities including the planning, evaluation, contract administration and performance monitoring.

3.6.129 Audit examination of the outsourcing guidelines utilised by each Group revealed that:

- the *Code of Practice - Outsourcing Process* issued by the SECV did not contain appropriate guidance, particularly in relation to identification and justification stages of the outsourcing process when compared with the *Guidelines for Contracting Out*, issued in May 1993 by the Office of State Owned Enterprises. Audit acknowledges that the May guidelines were issued after the tendering process had commenced for the majority of the SECV outsourcing arrangements;
- The *Purchasing Policy and Procedures* manual had been continually updated and contained standard tendering and contracting procedures; and
- The *Economic Evaluation of Expenditure Proposals* issued in March 1991 lacked:
 - full explanations and guidance in respect of economic terms and processes to be followed when performing an evaluation;
 - detailed explanations regarding the costs and benefits to be assessed as part of the evaluation; and
 - recognition of new economic evaluation techniques such as capital rationing, life cycle costing and replacement analysis.

3.6.130 Although supplementary economic evaluation guidelines were issued in relation to the evaluation of alternative financing, leasing, discount rates and the SECV's no new debt policy, the economic evaluation guidelines issued in March 1991 were not fully revised until December 1993, almost 3 years after their issue. During this period, decisions were made to outsource a significant portion of each Group's operations based on the results of the economic evaluations using guidelines which had become outdated. The shortcomings identified above have subsequently been addressed in the SECV's latest *Economic Evaluation Manual*.

3.6.131 In addition to the use of the documents mentioned above, each of the Groups also developed individual systems and procedures to facilitate outsourcing, however, there was no formal communication process between the Groups to share the knowledge gained, to capitalise on the lessons learned and to avoid any potential pitfalls. Given that the Production Group was the leader in outsourcing, communicating its considerable experience should have provided the Power Grid and Customer Services Groups with substantial benefits in terms of additional savings or increased efficiencies in the areas of contract administration, industrial relations and contract performance monitoring.

3.6.132 As the outsourcing process is relatively new to the public sector, communicating the lessons learned from the SECV's experiences can benefit not only the new Corporations but the public sector as a whole.

□ *RESPONSE* provided by the Administrator of SECV appointed under the Electricity Industry Act 1993

It is important to share the lessons learned from new innovative processes. This has occurred within the SECV, and by participation in external sessions.

The decision to outsource - evaluating outsourcing opportunities

Strategic business analysis

3.6.133 Both the SECV and the Office of State Owned Enterprises' outsourcing guidelines require that any outsourcing opportunities must be fully evaluated to justify whether functions or activities should continue to be performed internally or outsourced. The scope of the activity to be outsourced needs to be defined and involves identifying the current and excess service levels, possible improvements and expected benefits. This high level evaluation, often referred to as a strategic business analysis, requires that consideration be given to the:

- short and long-term financial analysis of the business;
- identification of internal and external threats;
- determination of the impact of outsourcing on key elements of the operating environment including industrial relations, human resources and government initiatives;
- determining the current and projected utilisation of the function or service to be outsourced; and
- evaluation of the available options including an assessment of the costs.

3.6.134 To date, the Power Grid and Customer Services Groups have outsourced only a limited number of activities. A review of the strategic business analyses performed by each of these Groups found such analysis contained appropriate assessments of each business to enable a soundly based decision on outsourcing to be made. However, with the Production Group, where the majority of the outsourcing was undertaken, audit was unable to determine the appropriateness of the decisions due to:

- the lack of analyses performed in some businesses prior to commencing the outsourcing process;
- the Group being unable to produce all the analyses for audit review; or
- the inadequate details contained in the analyses made available, to ascertain whether the decision to outsource was soundly based.

3.6.135 In addition, the Groups did not consider other options available such as management buyouts and joint venture agreements which may have achieved the same objectives as the option chosen in a more economic, effective or efficient manner. Audit noted there were a limited number of instances where bids were received for management buyouts, however, this option was not considered by the Groups in any of their strategy documents.

3.6.136 In view of the above factors, audit concluded that outsourcing was to be implemented irrespective of whether the best outcome to the Groups and the SECV overall could be achieved.

3.6.137 Before any future outsourcing arrangements are undertaken by the new corporations, there is a need for comprehensive strategic business analyses which take into account all options available to ensure that future decisions to outsource are justified and soundly based.

□ *RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993*

Given the number of international expert reports, restructures, external benchmarking, establishment of Profit Centres and the Maintenance Review it is hard to comprehend the value of further strategic business analysis. Outsourcing was seen as the best possible outcome for the SECV where it produced an economic benefit within a short period.

Establishing objectives and targets

3.6.138 In addition to undertaking a strategic business analysis, it is essential in any key initiative such as outsourcing to clearly define objectives that are supported by quantifiable benefits and savings. The parameters should be formally documented and understood by all those in the organisation involved in the outsourcing of the activities.

3.6.139 From an examination of the documentation held by each of the Groups, audit concluded that the key objectives for all outsourcing arrangements were to achieve a reduction in costs through a decrease in staff numbers, productivity improvements and the reduced likelihood for industrial disputation particularly in the Latrobe Valley. However, these implicit objectives were not documented, supported by strategies and targets or quantified, with the exception of projected savings for each outsourcing arrangement. Further, there was no clear correlation between the contribution to be made by each outsourcing activity to the overall Group objectives.

3.6.140 Audit considers that because of the failure to document strategies and targets the Groups are unable to determine whether the objectives and targets of outsourcing have been achieved and consequently whether the decision to outsource was in the best interests of the Government and the public.

3.6.141 **With any future outsourcing arrangements, objectives for each outsourcing proposal should be clearly identified, quantified and documented to enable effective evaluation as to whether the Groups' overall objectives are achieved.**

□ *RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993*

In relation to the Production Group, it clearly identified, quantified and published its macro business targets to which outsourcing was to make a substantial contribution. The key goal was to achieve a 35 per cent reduction in costs and the strategies included the number reductions, reduction in industrial issues, introduction of single union enterprise-based agreements, reduction in demarcations and substantial improvements in work practices.

The goals and strategies were clearly established and published. The benefits are now being monitored against the overall target set.

Selection of contractor

3.6.142 The selection of a contractor to undertake the function to be outsourced consists of the following distinct phases:

- advertising a Registration of Interest (ROI) - a public invitation to firms to register their interest in performing the function;
- issuing an Invitation to Tender (ITT) - a public or selective invitation to firms to tender for a function;
- evaluating the tenders received; and
- awarding the contract after obtaining the required approvals.

3.6.143 The contracting and tendering requirements should be fully documented with the key principles of value-for-money, open and effective competition, and ethical behaviour to be embodied in these requirements.

3.6.144 The submissions received should be subject to extensive analysis incorporating a cost-benefit analysis, cash flow projections, sensitivity analysis and include an evaluation of other key selection factors, such as the technical competence and financial viability of the tenderers. To increase the organisation's confidence in its selection of a provider, particularly in relation to major contracts, the selection process should be independently reviewed.

3.6.145 The SECV tendering and contracting requirements are included in its *Purchasing Policy and Procedures* manual. A comparison of these requirements with the processes adopted by the SECV revealed a number of deficiencies which are detailed below.

Seeking Registrations of Interest

3.6.146 The purpose of a ROI is to initiate the tendering process by giving all potential contractors the opportunity to register their interest. The manual requires that approval be obtained from the Manager-Contracts, Materials and Transport when ROI are not to be publicly advertised.

3.6.147 Notwithstanding this specific requirement, audit found 3 instances where the required approval was not obtained. In these cases experienced contractors known to the Groups were requested to submit a ROI. In 2 of these cases the industry register maintained by the State Industrial Office, which provides details of major suppliers for particular functions or services, was not utilised. Reference to this register would have provided the Groups with a more comprehensive list of prospective contractors rather than relying solely upon the knowledge of the Groups' employees of the main industry players.

3.6.148 Placing reliance on internal knowledge of potential suppliers rather than publicly advertising the ROI may lead to bias towards known suppliers and reduce the Groups' ability to obtain the best possible outcome.

3.6.149 In any future outsourcing arrangements, the new Corporations should ensure that all potential suppliers within the market are given an equal opportunity to register their interest.

□ *RESPONSE* provided by the Administrator of SECV appointed under the Electricity Industry Act 1993

The SECV agrees with the recommendation. It should be noted, however, that no complaints were received from any party about their being disadvantaged due to the practice undertaken.

Timing of Registrations of Interest and Invitations to Tender

3.6.150 Sufficient time should be provided to potential tenderers to prepare and submit detailed proposals to support their interests in particular contracts. The time frame established should take account of the potential for receipt of any overseas interests.

3.6.151 In view of the extent of the market available, it is important that open access be given to all firms with the required capacity and expertise to register their interest in order that the best available option can be selected. In audit view, this situation has not always occurred as evidenced by the following examples.

3.6.152 The outsourcing of activities within the Latrobe Valley has attracted interest from companies all over Australia and overseas seeking opportunities to expand their business operations.

3.6.153 The outsourcing of site maintenance at 3 power stations and 3 open cut mines, or any combination of these, with a total contract value in excess of \$200 million, attracted 23 proposals, including 2 from overseas. The documentation to be provided included strategies on maintenance of power stations and open cuts, human resources requirements, occupational health and safety issues, key personnel to be utilised and details of industry experience. Notwithstanding the magnitude and obvious complexity of the proposals, while at this stage detailed costing were not required, **only 24 days were given to the parties to lodge documentation supporting their proposals.**

3.6.154 Of the 23 proposals received, 6 companies were shortlisted and were issued with an ITT. Although the ITT requested detailed financial data for the provision of maintenance services for any combination of the 6 sites, **only 15 working days were allowed for this information to be provided.**

3.6.155 Audit was advised in discussions with Production Group officers that the unduly short time frame allowed for the preparation of the ROI and ITT was to minimise the opportunities for external parties, in particular the unions, to disrupt the outsourcing process. This was also confirmed in various strategy papers prepared by the Group in which the need to avoid any delays in the outsourcing program was stressed given the then stable but fragile industrial climate. Given the magnitude and complexity of this outsourcing arrangement, more time should have been given to prospective tenderers to submit ROI and ITT, thus ensuring that optimum market penetration was achieved. In this context, audit notes that the *Guidelines for Contracting Out* issued by the Office of State Owned Enterprises recommend that a minimum of 30 working days be given for a ROI.

3.6.156 In 2 other contracts valued at \$20 million and \$9.2 million, respectively, audit noted that ROI were advertised in only one newspaper with registrations closing in the month of January, giving interested parties only 3 weeks, including the Christmas holiday break when industries normally close down, to register their interest. In another contract valued at \$52.8 million, only 3 weeks, extending over the Easter break, were given to the prospective tenderers to register their interest.

3.6.157 In the above 3 cases the response from prospective tenderers was very poor, and the submissions received lacked quality and required further clarification and re-submission of essential information. These problems may have been avoided if a more reasonable period of time was given for such large submissions given that the services to be outsourced were readily available externally.

3.6.158 To ensure optimum market penetration and the achievement of the best possible outsourcing outcome, extensive canvassing in the market place should occur, and prospective contractors should be allowed sufficient time to submit detailed proposals. Although the industrial relations environment in the Latrobe Valley may be a sensitive issue and one which could jeopardise the success of outsourcing, the major objective should be the selection of the best and most cost-effective option.

□ *RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993*

The SECV had a full range of selection criteria on which to assess contractors' submissions. Only one of these criteria covered the industrial relations issues and in no situation was it considered to represent any more than 10 per cent of the criteria. It is incorrect to infer that it was the primary consideration. There is no justification for audit's inference that industrial relations resulted in any outcome other than the best and most cost-effective.

The SECV adopted normal processes for advertising tenders and for making the market aware of prospective opportunities. It is common practice for tenders to be advertised at the times noted by the Auditor-General.

Economic evaluations

3.6.159 An economic evaluation is undertaken to determine the most favourable option to carry out a specific function. In the case of outsourcing, such an evaluation systematically compares alternatives which have different costs, revenues, cost savings, escalations, lives, timing and risk. In addition, the evaluation takes into account the present day value of money through the use of discounted cash flow analysis.

3.6.160 The use of comprehensive economic evaluations provides the foundation for evaluating any proposals and influence outsourcing decisions.

3.6.161 The outsourcing proposals examined by audit had been evaluated by the Groups using the SECV's *Economic Evaluation of Expenditure Proposals* guidelines issued in March 1991. These guidelines require proposals to be reviewed by the SECV Treasury Department.

3.6.162 Audit found that the majority of the economic evaluations prepared by the Groups were not reviewed by the Treasury Department. In the Production Group the earlier evaluations had been reviewed by external consultants and the more recent evaluations had been reviewed by the Group's own Corporate Accounting section, due to the disaggregation of the SECV Treasury Department. As these reviewers of the evaluations, both internal and external, were also involved in their preparation the effectiveness of the review mechanism was reduced due to independence being compromised.

3.6.163 Where economic evaluation were performed, audit found that they were generally satisfactory and complied with the SECV guidelines. However, instances were noted where evaluations were not conducted with contracts being awarded on other grounds, such as the contractors' ability in the industrial relation arena. On one occasion, agreement was reached between the Chief General Manager and the tenderer for the provision of the service several days prior to the tender for the \$16.5 million contract being prematurely withdrawn.

3.6.164 **Audit considers that economic evaluations should be prepared for all significant outsourcing proposals. Such evaluations should be desirably performed by individuals not associated with the decision to outsource the activity to ensure the rationale and assumptions incorporated in the original decision are confirmed and to negate any indications of bias in awarding contracts.**

RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993

The SECV agrees with audit's recommendation.

It notes that audit found one instance when this was not done, this being one of the earliest outsourcing contracts.

The SECV notes audit opinion that all subsequent economic evaluations have been satisfactory. Given that these evaluations compare a "continue business as usual" scenario with a "contract-out" scenario, this is clear evidence that contracting-out is a sound business decision.

Awarding of contract and Board approval

3.6.165 In accordance with the requirements of the SECV *Purchasing Policy and Procedures* manual, approval by the SECV Board for any contract in excess of \$1 million is required at the tender recommendation stage. In all outsourcing activities reviewed by audit this approval had been obtained.

3.6.166 However, audit considers that obtaining the approval at the tender recommendation stage is too late in the process. By this stage, significant time and resources have been expended without any formal approval being obtained. It is possible that a tender recommendation may be rejected by the Board and substantial costs incurred with no benefit.

3.6.167 To avoid incurring unnecessary costs, audit recommends that approval in principle be sought from the Board of the new Corporations prior to commencing the tendering process.

Contractual arrangements

3.6.168 The tender process not only forms the basis for selecting a contractor, but outlines the principal terms and conditions to be included in the ensuing contracts. Copies of the SECV standard contract are issued with the Invitation to Tender. A contract should:

- include standard contract terms and conditions to ensure consistency with similar contracts;
- ensure price setting arrangements are reasonable and flexible in terms of changing conditions both internally and externally;
- provide the contractor with adequate incentive to operate efficiently and effectively; and
- ensure the interests of the organisation are protected by:
 - setting quality and quantitative performance targets and guarantees;
 - including appropriate default, penalty and insurance clauses in the event of poor performance;
 - excluding any guarantees or incentives that could impact adversely on outsourcing benefits; and
 - providing for a reasonable sharing of risks and benefits.

Contract fees

3.6.169 Since the move to outsourcing, the contracts entered into by the Groups have contained various bases for payment, such as:

- *Management fee contracts* - which provide for the payment of a service fee fixed for the duration of the contract. The fee covers the costs that are incurred by the contractor to manage the activities and includes the costs of administration, supervision, planning, engineering services, vehicles, tools, rent, training, the enforcement of quality standards and the infrastructure costs of communications. The management fee also covers one-off costs of establishment and demobilisation.
- *Performance - based management fee* - provides the contractor with the opportunity to increase profits for measured improvements in performance.
- *Fixed management fee* - involves the payment of a fixed profit for a specified period of time. The fixed element of management fee is not usually for the term of the contract, but provided only in the initial stages. After the fixed period has expired, payment is similar to a performance-based management fee contract in line with agreed performance targets.
- *Flat rate management fee* - is the cost of the contract for a nominated period. The cost includes labour and materials and plant and equipment charges. The flat rate is negotiated before entering into the contract and prior to the expiry of the nominated period.
- *Expenditure capping management fee* - involves fixing the cost of the contract for a nominated period. Expenditure in excess of the capped cost is to be borne by the contractor.
- *Schedule of rates (at market rates)* - the rates for the services to be rendered are set at market rates for a nominated period which is typically one year. The cost schedules relate to labour rates, material and plant and equipment charges and any other services that will vary in quantity according to the changing scope of work.
- *Cost - plus contract* - is a contract where costs are reimbursed plus an agreed profit margin. The agreed margin is set at a specified percentage for the duration of the contract.

3.6.170 The Production and Customer Services Groups initially entered into cost plus contracts and more recently moved towards management fee contracts which either provided for a fixed fee or a flat fee. The Production Group also entered into contracts based on a schedule of rates for services required at peak periods and recently entered into a performance-based management fee contract. The Power Grid Group has entered into a form of management fee contract with a schedule of rates covering particular items of work.

3.6.171 The 2 earlier cost-plus arrangements entered into by the Groups were recently renegotiated. The pricing methods used in these arrangements did not provide the contractors with an incentive to introduce productivity improvements and reduce costs, therefore, the anticipated savings from these arrangements were not achieved. The pricing methods have now been changed to a fixed management fee and an annual capping of expenditure, respectively.

3.6.172 Since the commencement of outsourcing within the Groups, there has been a noticeable change in focus from the need to avoid industrial relations disputes and reduce manning levels to the need to find a more economic, efficient and effective way of performing non-core activities.

3.6.173 **When the current contracts are due for renegotiation or when entering into new contracts, the new corporations should consider adopting performance-based management fee contracts. In audit opinion, these contracts provide an opportunity to obtain greater savings and the ability to ensure improved quality and service delivery while maintaining ultimate management control of the activity.**

□ *RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993*

The SECV supports this recommendation. A number of contracts include this provision within their current term.

Financial incentives

3.6.174 When entering into any contractual arrangement an organisation needs to ensure its interests are protected and there is an appropriate sharing of risks and benefits. There should not be any unreasonable guarantees or incentives and any indirect subsidisation, where justified, should be quantified and factored into the final agreement.

3.6.175 A review of the contractual arrangements entered into by the various Groups revealed certain expenses which, in normal circumstances one would expect would be borne by the contractors, were specifically paid for or reimbursed by the Groups. Examples of these are:

- *Payment of future redundancy packages*

Since 1989, 2 878 SECV employees have become redundant as a result of the outsourcing of many of the SECV Groups' activities. Of the redundant employees, 1 971 accepted a Voluntary Departure Package (VDP) of whom 1 434 were subsequently employed by contractors. Of the remaining employees, 134 were redeployed within the Groups and 773 remain surplus to the Groups' requirements.

Despite the employees receiving VDPs, the contractual arrangements entered into between the SECV and the contractors included a provision for the SECV to subsidise the contractors for the payment of any future redundancy packages that may be paid to the same employees. These arrangements provided for:

- Inclusion of the provision for redundancy in the labour rate schedule. This provision accounted for between 7 to 9 per cent of labour costs per employee with the full labour cost paid by the Group to the contractor; or
- Inclusion of a provision for redundancy in the management fee; or
- The contractor being reimbursed for any future redundancy packages to ex-SECV staff as they occur.

Under the first 2 arrangements, even when the employees do not become redundant during the contract term, the financial consideration relating to the redundancy provision is not refundable.

Although audit was advised by a consultant to the SECV that such costs are usually reflected in the pricing structure of any management fee contract payment, inquiries by audit did not substantiate this conclusion. Payment of redundancies is a cost of employment and, in audit opinion, should be borne by the current employer, as the risks and benefits of employing staff are transferred to the contractor when the ex-SECV employees became employees of the contractor.

Audit has been unable to establish a government policy in regard to this issue, however, given the significant ramifications in terms of cost, such a practice is not considered commercially wise and results in unnecessary costs, particularly if employees do not subsequently become redundant.

■ *Payment to contractor for idle resources*

In 1991, the SECV outsourced the transport function for a period of 5 years at a cost of \$17.5 million. As part of the contract negotiations, the contractor was to employ a specific number of former SECV employees previously engaged to provide this service in-house.

In recognition of the fact that not all the employees would be necessary to provide the service, the SECV agreed to compensate the contractor if these employees could not be fully utilised. In 1992-93, such compensation, which also included compensation for idle vehicles, amounted to \$1.5 million or 42 per cent of the average annual cost of the service of \$3.5 million. This arrangement was not explicitly provided for in the terms and conditions of the contract.

Following subsequent recognition by the SECV of the unfavourable terms of the contract, the SECV was able to negotiate a reduction in the contract fee which effectively reduced the compensation element from \$1.5 million to \$900 000 a year.

It became apparent to audit that the management decision to succumb to such an incentive was influenced by the Group's objective to reduce its workforce, irrespective of the economic benefit from a contract. Any potential benefits from outsourcing in this instance were a secondary consideration.

■ *Minimum work guarantees*

In the contracting-out of one service, the contractor was guaranteed a certain level of activity with an entitlement to receive payment if this level was not achieved. The guaranteed work levels were not achieved in the first month of the contract and the contractor received monetary compensation equivalent to \$30 an hour for every hour of idle time below the guaranteed threshold.

- *Payment of mobilisation and demobilisation costs*

Another major outsourcing contract entered into by one of the Groups provided for a one-off fee of \$300 000 to be paid to the contractor for establishment costs incurred in taking possession of an existing facility. In addition, the contractor is to be paid a further \$300 000 if he does not elect to take up the option to extend the contract term for a further 3 years. In audit opinion, such contract incentives are generous, particularly the demobilisation costs given that the decision of whether to take up the 3 year option rests with the contractor.

3.6.176 While acknowledging that in the longer-term the outsourcing activities will result in operational savings, the benefits to the taxpayer from outsourcing can be significantly negated if incentives and concessions of the nature described above are included in contracts. In audit opinion, such practices are considered to be commercially unwise and consideration should be given to renegotiating contracts which have such provisions.

3.6.177 Given the generosity of the above arrangements, it is not surprising therefore, that outsourcing arrangements have, as stated previously, been implemented with a minimum of industrial unrest.

□ *RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993*

No incentives have been offered to contractors.

Contractors expect to be able to recover costs and to make a profit. As a part of doing business, each contractor negotiated an enterprise-based agreement and these agreements all contained costs for redundancy. Therefore, a contractor looking to cover his legitimate costs has sought to ensure that his contract included costs incurred for redundancy. This is a straight commercial arrangement and not an incentive.

The fact that all contracts were arranged following competitive tendering is at odds with the opinion of audit that arrangements were generous. Audit has not provided any justification for its conclusion.

Performance monitoring and reporting

3.6.178 To determine whether the objectives anticipated from outsourcing have been achieved, appropriate policies, systems and procedures must be developed to enable management to monitor the performance and progress of each contract. To measure performance, each contract needs to have clearly established objectives and quantifiable criteria. Performance indicators should then be developed which are realistic, meaningful and subjected to regular review with all identified variances actioned.

3.6.179 Timely, comprehensive and meaningful management information systems are required to enable sound management decision-making. There should be a thorough analysis of performance against the organisation's budget, agreed contractual and management performance indicators, related targets and historical trends for

- service delivery;
- cost-efficiency; and
- achievement of predicted net cost-benefits and other objectives.

3.6.180 In fulfilling its role the Board should be provided with progress reports on achievements to date and any problems associated with specific contracts. As part of an organisation's public accountability it should report its achievements in outsourcing in its *Annual Reports* and subsequently to Parliament.

3.6.181 The audit review revealed an almost total absence of monitoring of the contracts entered into by the 3 Groups. Specifically, it was found that:

- It was not until July 1993 that the Production Group established a Contract Support Unit (CSU). The role of the Unit was to assist in the tender evaluation, contract preparation and the monitoring and evaluation of activities outsourced. The Power Grid and Customer Services Groups had not established such units, possibly due to the fact that the outsourcing contracts entered into by these 2 Groups did not provide for regular reviews of the contractors' performance;
- Despite the fact that the SECV's *Economic Evaluation and Expenditure Proposals* guidelines require that post-implementation reviews be performed, no such reviews have been performed by any of the Groups;
- The General Manager of each Group and the SECV Board were provided with reports relating to the performance of any outsourcing arrangement on an exception or request basis only;
- The Groups had not assessed the direct impact outsourcing had made on the Groups' stated objectives regarding the reduction of costs, reductions in staff numbers and debt; and
- The Groups had not established a framework to facilitate the reporting of achievements from the outsourcing process to the Parliament.

3.6.182 Notwithstanding the positive move by the Production Group in establishing the CSU in July 1993, it took until December 1993 before the Group issued guidelines outlining the procedures to be implemented for the monitoring and evaluation of the activities contracted-out.

3.6.183 A review of the above guidelines revealed that they were not comprehensive and will need to be supplemented by the development of systems and procedures to obtain, collate and analyse the performance data relating to contracts.

3.6.184 This is particularly important as the reports presently submitted by contractors are general in nature and are not considered by audit to be adequate in providing the Group with useful data and statistics from which the contractors' performance can be monitored on a regular basis.

3.6.185 Overall, in audit opinion, effective monitoring and evaluation of outsourcing arrangements has not occurred to date. Assessing the impact of outsourcing on operations is crucial in terms of determining whether the policy objectives of both the organisation and government have been met and value-for-money is achieved. Such assessments should involve:

- conducting post-implementation reviews as closely as practicable after the letting of the contract to ensure that any deficiencies identified with the outsourcing arrangement are addressed in future contracts;
- developing systems and procedures to ensure contractors' performance can be adequately monitored and evaluated;
- establishing a reporting framework to senior management and the Board on the achievements of outsourcing compared with stated objectives and a status report on contractor performance on a regular basis; and
- establishing an accountability framework to Parliament by reporting the achievements from outsourcing in the new corporations' *Annual Reports*.

□ RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993

The SECV does not understand the breadth of audit's criticism.

- *Post-implementation reviews can only be effectively conducted when a contract is in place and operative. There is no value in doing such a review immediately after contract placement.*
- *Contract reporting is being provided through normal management reporting channels. Exception reporting highlights where performance is not in accordance with derived or expected results.*
- *Timely reporting has been provided to the Minister and Parliament.*

Voluntary Departure Packages

3.6.186 Since 1989, the SECV has initiated a number of programs aimed at improving productivity. One of these initiatives has been to reduce staff numbers to levels compatible with operational requirements. A key objective of outsourcing has been to maximise the number of SECV employees moving to contractors thus, reducing the cost associated with employment and industrial disputes.

3.6.187 With the outsourcing of many of the SECV Groups' activities, a number of employees became redundant or were subsequently redeployed within the Groups. This situation was particularly prevalent in the Production Group where 2 388 employees have become redundant since 1989. These employees had the option to accept a Voluntary Departure Package (VDP) or to be redeployed within the SECV. Of the redundant employees, 1 586 accepted a package, 29 were redeployed within the Group and 773 have become surplus to the Group's requirements. Of the employees who accepted a VDP, 1 269 (or 80 per cent) were subsequently employed by contractors.

Surplus employees

3.6.188 The Production Group has established a taskforce to redeploy the 773 staff surplus to immediate requirements. The key role of this taskforce is to ensure such employees are gainfully employed by identifying alternative work opportunities within the Group.

3.6.189 The surplus employees include technical officers, administration officers, work group supervisors and qualified trade persons. These employees are now involved in activities such as tree planting, cleaning, gardening, minor maintenance, community work and assisting other government agencies on a needs basis - activities that do not contribute to the income generating capacity of the Group. Regardless of the value of the work performed, all surplus employees in the Group have retained their previous base salary level.

3.6.190 The cost of employees of VDPs and the costs associated with the continuing employment of surplus staff was included in the economic evaluations. The first maintenance contracts assumed that all surplus staff would have left the SECV by December 1993, an assumption that did not properly take into account employment prospects in the Latrobe Valley. This assumption was subsequently revised with a projection that surplus staff will depart the SECV progressively over a 2 year period from the outsourcing of any given activity.

3.6.191 It is estimated that each surplus employee costs the Group on average \$45 000 a year. If these surplus employees elect not to leave the organisation and the Group continues its policy of offering VDPs only, the annual cost to the Group will amount to around \$35 million. Depending on the length of time these surplus employees remain with the Group, there will continue to be an adverse impact on the anticipated savings and cost targets from the outsourced activity.

3.6.192 Given that the SECV currently employs 773 employees in the Production Group that are surplus to requirements, consideration should be given to other forms of inducement or negotiating a compulsory retirement package. Unless such action is taken, the expected savings from outsourcing will be substantially reduced.

□ *RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993*

This matter is under constant review between the management and Boards of the new corporations, and with the appropriate Cabinet Ministers.

Audit's recommendation on this is simply stating the obvious.

NEW HEAD OFFICE ACCOMMODATION

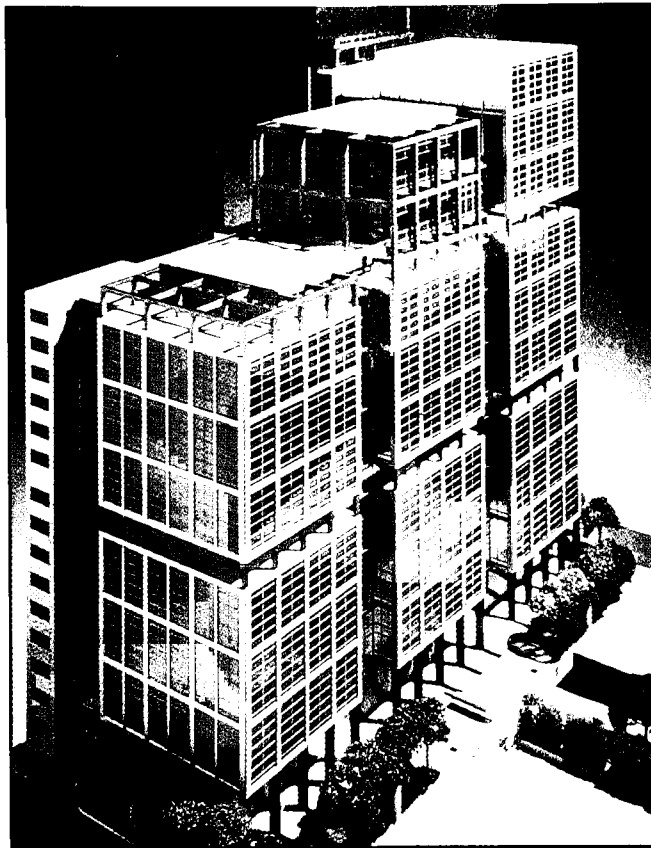
3.6.193 During the latter part of the 1980s the SECV recognised that its Monash House head office in William Street, Melbourne, was in need of substantial refurbishment and was unable to satisfy its long-term accommodation needs. This was reflected in the growing maintenance costs incurred and the deteriorating standard of the building.

3.6.194 In late 1990, following the financial and economic evaluation of a series of options, the SECV endorsed a strategy aimed at solving its long and short-term accommodation problems by relocating in a new building to be constructed on land adjacent to Monash House.

3.6.195 The proposal involved the following:

- A developer would buy the SECV's land adjacent to Monash House and construct a building of approximately 40 000 square metres, including parking for 350 vehicles, designed to meet the SECV's requirements. Construction was to be completed by July 1994;
- The SECV would lease the building as its corporate headquarters for a period of 20 years; and
- Monash House would be sold and leased-back during the construction of the new head office building and be vacated upon completion of the new building.

3.6.196 The sale of the land was effected in May 1991, prior to the close of the 1990-91 financial year, and an agreement to lease was executed in July 1991 between the SECV and Grocon Limited. The agreement provided for the developer to purchase the site adjacent to Monash House for \$10 million and construct a 21 level office tower of 40 000 square metres. The agreement also provided for Grocon Limited to pay the SECV an incentive payment of \$15 million and to include a \$40 million fit-out in the new building.



New SECV head office accommodation.

3.6.197 The SECV agreed to lease the new office building from the developer for a period of 20 years at a fixed amount of \$32.4 million a year, payable monthly. The lease was to commence upon completion of the building around June 1994.

3.6.198 Concurrently, the SECV gave approval for the sale of the Monash House building, with provision for the lease-back of the building. Monash House was sold in September 1991 to an overseas investor for \$40.1 million and the SECV leased it back for a period of 3 years and 9 months at a cost of \$10.6 million a year. A feature of the lease-back arrangement was that the SECV agreed to pay rent at a much higher rate than market rent in return for an up-front cash payment of approximately \$28 million.

3.6.199 At the time of entering into the lease, the Government and the SECV had commenced pursuing a major program of corporate reform evidenced by a decline in staff numbers from 21 551 at 30 June 1989 to 15 870 at 30 June 1991, with approximately 2 170 staff located in 3 buildings within the Melbourne central business district. The reform also encompassed the strengthening of the role of regional offices and a streamlining of head office departments.

3.6.200 Although construction of the building is now complete and rental was payable from 1 April 1994, uncertainty surrounds the future occupancy of the building. Staff numbers have declined to approximately 10 000 (with approximately 1 000 located within the central business district) and the Victorian electricity industry is undergoing a major restructure. A key feature of the restructure has been the establishment of 3 separate State-owned corporations with further disaggregation expected under the current government policy.

3.6.201 Currently, pursuant to the State Government's review of the structure and operation of the electricity supply industry, the options in respect of this building are being reviewed by the Departments of Finance, the Treasury, and Energy and Minerals. In this regard, in March 1994, the Minister for Energy and Minerals and the Treasurer advised the 3 corporations that it would be inappropriate for them to move into the building, as previously contemplated, during the review process.

3.6.202 The above scenario is similar to the experiences associated with the Gas and Fuel Corporation's new head office building mentioned earlier in this Report. It again highlights the difficulties faced by an organisation entering into long-term leasing arrangements in an environment of uncertain structural reform.

RESPONSE provided by the Administrator of SECV appointed under the Electricity Industry Act 1993

The Administrator declined to submit for publication any response to this issue.

THEFTS AND LOSSES

3.6.203 Losses of cash, stores and plant and equipment for the period 1 January to 31 December 1993 reported to audit by the entities within the Energy and Minerals portfolio were as follows:

- Gas and Fuel Corporation of Victoria, \$ 173 800; and
- State Electricity Commission of Victoria, \$331 700.

3.6.204 The thefts and losses reported by the State Electricity Commission of Victoria included a loss of \$218 400 as a result of storm damage at the Commission's Benalla regional office. This loss was not covered by insurance.

**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
MATTERS RESOLVED OR ACTION COMMENCED		
DEPARTMENT OF ENERGY AND MINERALS		
<i>Ministerial Portfolios, May 1992, pp. 243-7.</i>	The Gas and Fuel Corporation did not have procedures in place to provide assurances that its workshops were operating efficiently and meeting established business goals.	<p>A number of procedures have been implemented by the Corporation to improve the operations of its workshops, including:</p> <ul style="list-style-type: none"> ▪ the introduction of standard times for pre-determined services; ▪ monitoring of job times by service managers; and ▪ downsizing of manning levels in workshops.

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Department of Energy and Minerals	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	8 Sept. 1993	14 Oct. 1993
Coal Corporation of Victoria	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	24 Aug. 1993	25 Aug. 1993
Everton Dell Pty Ltd	30 June 1993	No reporting requirements. Audit conducted at request of Treasurer and under the Corporations Law.	2 Sept. 1993	3 Sept. 1993
Gas and Fuel Corporation of Victoria	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	29 Sept. 1993	30 Sept. 1993
Gas and Fuel Corporation Superannuation Fund	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i> Extension granted to 30 November 1993.	21 Oct. 1993	5 Nov. 1993
Loy Yang B Power Station Pty Ltd	30 June 1993	No reporting requirements. Audit conducted at request of Treasurer and under the Corporations Law.	26 Aug. 1993	3 Sept. 1993
National Electricity Pty Ltd	30 June 1993	" "	14 Jan. 1994	31 Jan. 1994
National Power Pty Ltd	30 June 1993	" "	14 Jan. 1994	31 Jan. 1994

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
Renewable Energy Authority Victoria	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	21 Sept. 1993	22 Sept. 1993
SEC Superannuation Fund	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i> Extension granted to 30 November 1993.	29 Oct. 1993	29 Oct. 1993
SECV International Pty Ltd	30 June 1993	No reporting requirements. Audit conducted at request of Treasurer and under the Corporations Law.	1 Sept. 1993	3 Sept. 1993
SECV Superannuation Pty Ltd	30 June 1993	" "	29 Oct. 1993	29 Oct. 1993
State Electricity Commission of Victoria	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	2 Sept. 1993	3 Sept. 1993

Part 3.7

Finance

KEY FINDINGS

DEPARTMENT OF FINANCE

Departmental cash management

- Significant improvements have occurred in departmental cash management since the audit review of this activity in 1984.

Paras 3.7.11, 3.7.16 and 3.7.17

- The Department of Finance needs to assess whether more cost-effective banking services would eventuate from publicly tendering for such services.

Paras 3.7.18 to 3.7.24

- Although the Department of Finance has a bank account management system in place to monitor departmental bank account balances, it has been unsuccessful in persuading individual departments to remit excessive balances to the Public Account.

Paras 3.7.34 to 3.7.38

- The Department of Finance needs to encourage the extended use of electronic funds transfer facilities by departments and initiate appropriate measures for the adoption of these facilities where savings can be achieved.

Paras 3.7.39 to 3.7.45

3.7.1 The Minister for Finance has responsibility for operations within the Finance sector. Details of the specific ministerial responsibility for public bodies within the Finance sector are listed in Table 3.7A. These public bodies, together with the Department of Finance, are subject to audit by the Auditor-General.

TABLE 3.7A
MINISTERIAL RESPONSIBILITY WITHIN THE FINANCE SECTOR

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Finance	Emergency Services Superannuation Board Government Employee Housing Authority Hospitals Superannuation Board Local Authorities Superannuation Board State Casual Employees Superannuation Board State Employees Retirement Benefits Board Surveyors Board of Victoria Transport Superannuation Board Victorian Superannuation Board, administering: <ul style="list-style-type: none"> • Coal Mine Workers' Pensions Fund • Holmesglen Constructions Superannuation Plan • Parliamentary Contributory Superannuation Fund • State Superannuation Fund • Victorian Superannuation Fund (a)

(a) Commenced operation on 1 January 1994.

3.7.2 Comment on matters of significance arising from the audit of the Department of Finance is provided below.

DEPARTMENT OF FINANCE

DEPARTMENTAL CASH MANAGEMENT

3.7.3 The legislative and administrative framework governing departmental accounting for the receipt and payment of public moneys, at the time of preparing this Report, was set out in the *Constitution Act 1975*, the *Public Account Act 1958* and the *Audit Act 1958*. In addition, policy guidelines and circulars are issued from time-to-time by the Department of Finance, as the central agency responsible for the overall management of the Public Account which is the Government's central bank account. As stated in the Foreword to this Report, substantial changes to the financial management and audit legislation have been made in the current session of Parliament.

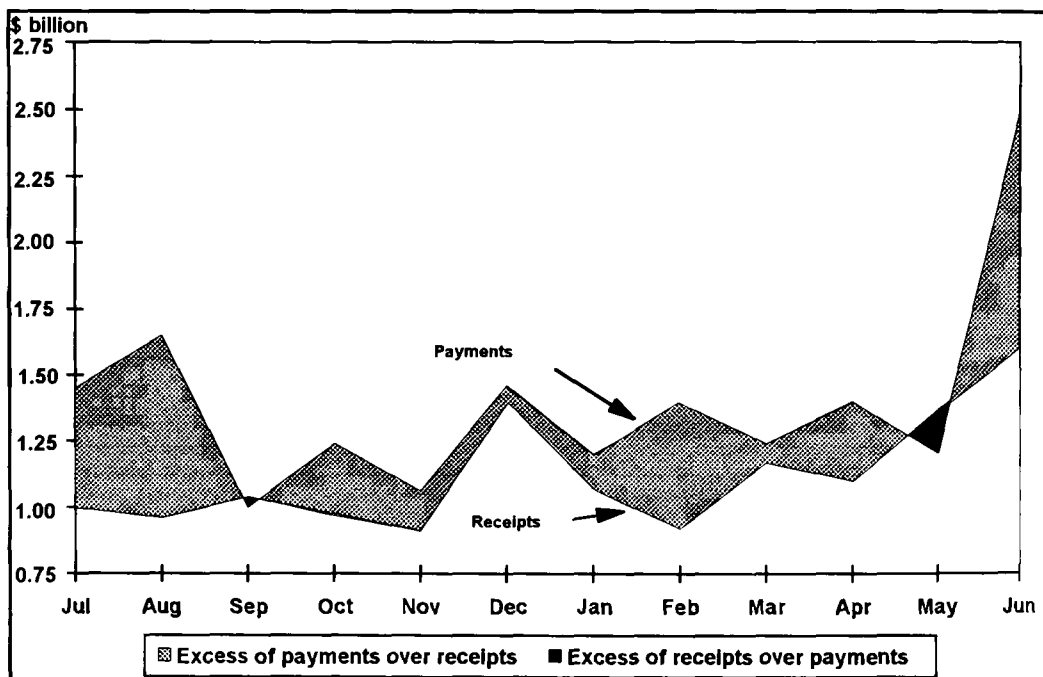
3.7.4 Under the established framework, departmental financial transactions are accounted for within the Public Account, which comprises the Consolidated Fund and the Trust Fund. The Consolidated Fund is the main operating fund and records the collection of all government revenues, such as State taxes, Commonwealth grants and asset sale proceeds, together with payments made by departments against parliamentary appropriations. The transactions of the Trust Fund are of a more restricted nature and mainly cover moneys held in trust, the disbursement of Commonwealth grants to designated recipients, and the operations of departmental suspense and working accounts.

3.7.5 The Public Account processes cashflows in excess of \$60 billion annually. In addition, departments maintain separate revenue and advance (payment) bank accounts to facilitate the movement of receipts and payments between the departments, taxpayers, creditors, other payees and the Public Account. Banking services for the Public Account and departments are provided by 4 major Australian banks, with commercial rates of interest paid by the banks on all bank account balances.

3.7.6 In recent years, governments have pursued budgetary deficit policies which, in simple terms, have resulted in Consolidated Fund payments exceeding receipts, with annual shortfalls being financed by borrowings. Additionally, because the receipt and payment cashflows of the Public Account do not always coincide during the course of a year, short-term borrowings are raised to meet any cash shortages as they arise.

3.7.7 Chart 3.7B illustrates the differential between cash inflows and outflows of the Consolidated Fund during 1992-93, which must be funded by borrowings.

CHART 3.7B
CONSOLIDATED FUND MONTHLY CASHFLOWS, 1992-93
(excluding borrowings)



Source: Statement of Budget Sector Transactions (monthly Niemeyer Statements).

3.7.8 Given the volume of cash processed through the Public Account and departmental bank accounts, effective cash management policies and processes at both the central agency and departmental levels should be established to ensure that departmental cash needs are accurately assessed, borrowings and associated interest costs are minimised, and any surplus cash within the Public Account is promptly invested.

3.7.9 The Comptroller-General's Division of the Department of Finance has overall responsibility for the operations of the Public Account. Specific processes of the Division to manage Public Account cashflows include:

- developing cash management policies for departments;
- co-ordinating and monitoring of daily and short-term cash forecasts;

- estimating daily, on a rolling 12 weekly basis, the overall net cash position of the Public Account and determining the appropriate borrowing or investment strategy;
- the timely release of funds from the Public Account to departments to meet current expenditure obligations; and
- maintaining the Public Account bank accounts and monitoring departmental bank account balances.

3.7.10 The role of individual departments in the overall cash management processes includes:

- implementing the directives and guidelines issued by the Department of Finance on cash management;
- preparing and monitoring cash forecasts of revenue and expenditure to determine daily cash requirements from the Public Account;
- clearing revenue collections to the Public Account on a timely basis; and
- managing revenue and advance bank account balances.

3.7.11 The October 1984 Auditor-General's *Special Report No. 3, Departmental Cash Management* outlined the results of an audit review of departmental cash management arrangements and highlighted significant management deficiencies, resulting in the forgoing of interest revenues. These deficiencies included:

- inadequate cash management processes and systems at the central agency level;
- lack of review of interest rates payable on Public Account bank accounts;
- non-interest earning nature of many departmental bank accounts;
- unnecessary cash balances maintained in departmental advance accounts;
- delays in the clearance of revenue to the Public Account; and
- extensive use of cheques to settle inter-departmental obligations.

3.7.12 It is against the above background that audit carried out a review of current policies and processes established to manage Public Account cashflows.

3.7.13 The overall objective of the review was to assess the effectiveness of the Department of Finance and departments in managing Public Account cashflows so as to minimise interest charges associated with borrowings and maximise interest income.

OVERALL CONCLUSION

3.7.14 In general, the framework established for Public Account and departmental cash management was effective in ensuring that State financing costs were minimised and interest revenues maximised.

3.7.15 However, there still remains scope to further enhance existing cash management processes and generate budgetary savings for the State, through:

- rationalising Public Account and departmental banking arrangements;
- improving departmental cashflow forecasting and management processes; and
- utilising electronic funds transfer (EFT) banking services more extensively.

Developments in cash management since the previous Auditor-General's review

3.7.16 Since the 1984 audit review, significant improvements have occurred which have resulted in enhanced departmental cash management arrangements and outcomes. Specifically, the Department of Finance has:

- Issued various policy circulars and guidelines to departments, outlining procedures to improve the efficiency of cash management;
- Introduced the requirement for departments to prepare detailed periodic cashflow forecasts to assist in determining the overall daily cash needs of the Public Account;
- Developed the *bank account management system* to enable the on-line monitoring of transactions and balances of the Public Account and departmental bank accounts;
- Successfully negotiated with the State's bankers to obtain commercial rates of interest on all departmental bank accounts;
- Conducted reviews of banking arrangements with a view to rationalising the number of bank accounts and reducing associated administrative costs. These reviews have resulted in a reduction of around 1 000 bank accounts and have created administrative efficiencies; and
- Established procedures for the more timely receipt of moneys into the Public Account.

3.7.17 While these initiatives have provided significant efficiency improvements in Public Account cash management, the current audit review has identified a number of matters, as outlined throughout this Report, which, if addressed, could further supplement the efficiencies achieved to date.

Banking arrangements

3.7.18 Banking services for the Public Account and departments are provided by 4 major Australian banks - Westpac Banking Corporation, Australia and New Zealand Banking Group Limited, National Australia Bank Limited, and the Commonwealth Bank of Australia.

3.7.19 The moneys standing to the credit of the Public Account are held in the 4 banks, while departments operate around 700 bank accounts with these banks. Interest rates and fees payable on the bank accounts are negotiated by the Department of Finance with the individual banks and are reviewed annually.

3.7.20 The State's choice of bankers for the Public Account and departmental banking operations should ensure the provision of the most efficient banking services, commensurate with the operating needs of participating organisations. The principle of sharing the banking business of the Public Account and departments among the existing 4 banks was primarily derived from an agreement negotiated by the Treasurer with the banking industry in 1903. However, the Department of Finance has advised that the agreement is outdated and irrelevant in the context of current arrangements with the banks. The appointment of the current banks as successors-in-law to the parties to the 1903 agreement is mainly a consequence of the takeovers and mergers which have occurred in the banking industry since that time.

3.7.21 An internal review of banking arrangements by the Department of Finance in 1991 indicated that any new arrangements should clearly specify, *inter alia*, future requirements in respect of facilities such as electronic fund transfers, electronic information interchange and after hours deposits. The internal review concluded that overall banking arrangements should be reviewed to provide the Government with the opportunity to gain the most cost-effective banking services and that the preferred option was that the process be settled by public tender.

3.7.22 Inquiries with Treasury officials in New South Wales, Queensland and the Northern Territory indicated that these States have recently appointed bankers on the basis of public tender. Officials in these States and a review of documentation made available to audit indicated that various efficiencies had been achieved by opening the banking services to competition. Benefits included:

- introduction of new banking technologies and services, such as electronic fund transfer facilities and automatic investment of surplus funds;
- single, annual fee arrangements; and
- improved overall cash management through the rationalisation of bank accounts and enhanced administrative arrangements.

3.7.23 The 1992-93 *New South Wales, State Budget Paper No. 2*, indicated that savings of around \$7 million were expected to accrue over the ensuing 5 year contract period, from a *reduction in bank charges and improved services*, by the tendering of banking services.

3.7.24 While audit acknowledges the varying conditions in which individual States undertake their banking operations, past experience has shown that significant benefits have been achieved through tendering of banking services. The Department of Finance needs to assess whether more efficient and cost-effective banking services would eventuate from publicly tendering for banking services, as envisaged in its 1991 review.

□ *RESPONSE provided by Comptroller-General*

The Department of Finance considers that the competitive banking arrangements negotiated by the Department are in the best interests of the State and the specialised services offered by the banks to a range of departments are operating satisfactorily.

The Department of Finance negotiates banking arrangements on an annual basis and departments are advised of the best available pricing.

Cash forecasting processes

3.7.25 To ensure that Public Account cash management processes are effective in minimising borrowing needs and associated interest costs, and provide sufficient cashflows to meet departmental expenditure commitments, a comprehensive cash management framework should operate which includes:

- policies and guidelines that prescribe the respective cash management roles and responsibilities of the Department of Finance and other departments;
- efficient and effective processes within departments to ensure the timely provision of accurate and reliable cashflow information to the Department of Finance;
- reliable information systems and adequate priority given to facilitate accurate cashflow forecasting for the daily cash requirements of the Public Account and departments; and
- performance indicators to facilitate regular assessments of whether the cash position of the Public Account and departmental bank accounts is optimised.

3.7.26 As previously commented, audit found that the Department of Finance has been generally effective in developing policies and procedures for the efficient management of the Public Account's cash resources. However, certain forecasting and monitoring deficiencies have been identified which have reduced the overall effectiveness of Public Account management. These deficiencies are discussed below.

Forecasting of cash requirements

3.7.27 The Department of Finance has responsibility for ensuring adequate cash resources are available to fund the operations of the Public Account. For most of the year, cash outflows exceed cash inflows (excluding long-term borrowings), resulting in a net cash position that requires financing from temporary borrowings. The Department has in place the following cash management guidelines to ensure that daily borrowing levels equate to the actual cash needs of departments:

- as a general principle, cash is to be provided to departments on a *needs only* basis;
- for most departments, receipts credited to revenue bank accounts are to be cleared to the Public Account on the day of receipt; and
- departments are required to maintain cash balances in advance bank accounts as *close as possible* to a nil balance.

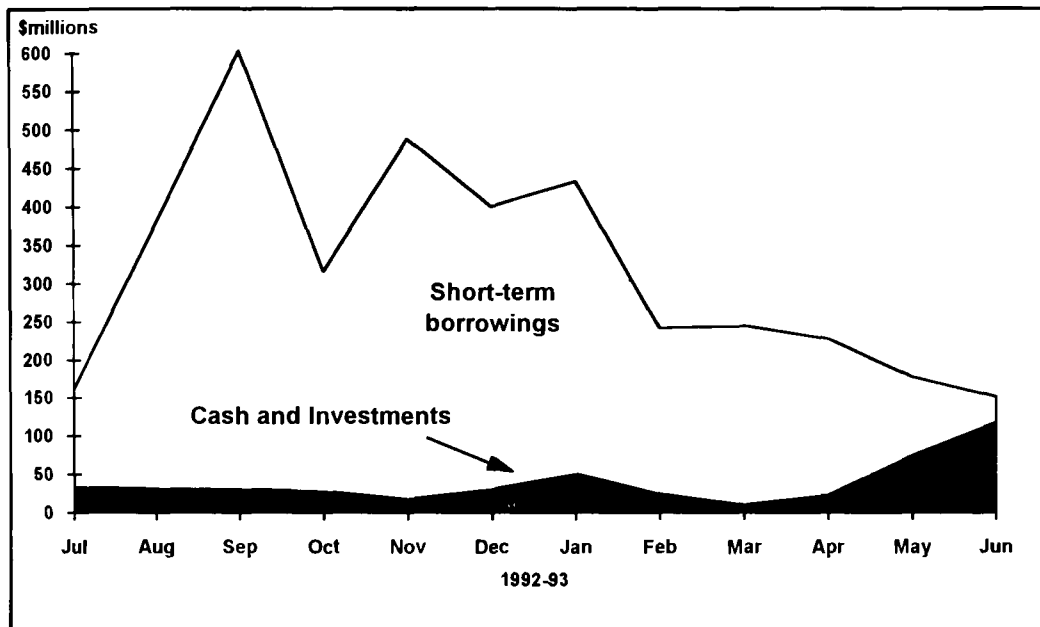
3.7.28 Key processes utilised by the Department to ensure sufficient cash resources are available to meet outgoings include:

- a requirement for departments to provide on a weekly basis, daily cashflow forecasts covering the ensuing 12 week period;
- daily contact with major departments to determine if revisions to cashflow forecasts are required;
- estimating borrowing needs on a daily basis, following an analysis of departmental forecasts of receipts and payments, estimated borrowing repayment obligations and cash and investment balances on hand;
- determining total cash needs by 11 a.m. to enable access to the short-term money market at its most favourable time;
- monitoring major cashflow movements throughout the remainder of the day, with the investment overnight of any surplus cash arising within the Public Account; and
- monitoring of bank account balances through the *bank account management system*.

3.7.29 In addition, departments are provided on a monthly basis by the Department of Finance with a report detailing daily cashflow variances and advance account bank balances to facilitate the identification of their forecasting deficiencies, with a view to enhancing future cashflow forecasts.

3.7.30 The overall effectiveness of these processes can generally be assessed by reviewing the level of short-term borrowings relative to cash and investment balances. Such balances if excessive are an indicator of poor cash management. Chart 3.7C provides a comparison of the level of short-term borrowings relative to cash and investment balances for the 1992-93 financial year.

CHART 3.7C
SHORT-TERM BORROWINGS
AND AVAILABLE CASH AND INVESTMENT BALANCES
 (Average monthly balances)



Source: Department of Finance, Management Information Systems.

3.7.31 The above chart discloses that the assessments by the Department of Finance of Public Account cash requirements in 1992-93 resulted in the maintenance of an average monthly cash and investment balance for the Public Account and departmental bank accounts of \$40 million. A key factor contributing to this situation was the provision by various departments of inaccurate cashflow projections to the Department of Finance. The audit review identified that inaccurate cashflow projections were mainly due to:

- insufficient attention devoted by departments to the cashflow forecasting function;
- deficient cashflow prediction methods, with cashflow forecasts based on:
 - previous transaction history rather than up-to-date budget information; or
 - simplistic forecasting of expenditure patterns rather than detailed cheque presentation analyses; and
- decentralised accounting systems which did not interface with departmental cashflow forecasting systems.

3.7.32 In light of the Department of Finance's policy of providing cash on a *needs only* basis, and in recognition of the requirement of departments to maintain minimal bank balances, the existence of such significant cash balances indicates a need to improve the forecasting process. The financial consequences of obtaining borrowings in excess of actual cash needs during 1992-93 was estimated by audit to be additional net interest costs of around \$300 000.

3.7.33 Audit acknowledges that complete accuracy in forecasting in some key areas of government activity, such as the collection of stamp duties, is not always possible. Nevertheless, audit is of the view that a greater degree of reliability and improved cash management could be achieved through:

- the departmental cash management function being given greater attention;
- implementation of enhanced cashflow projection models by departments;
- timely follow-up by respective departments to identify reasons for variances between forecast and actual cashflows, together with appropriate future corrective action; and
- the greater utilisation of simplified payment procedures such as payments by electronic fund transfers.

□ RESPONSE provided by Comptroller-General

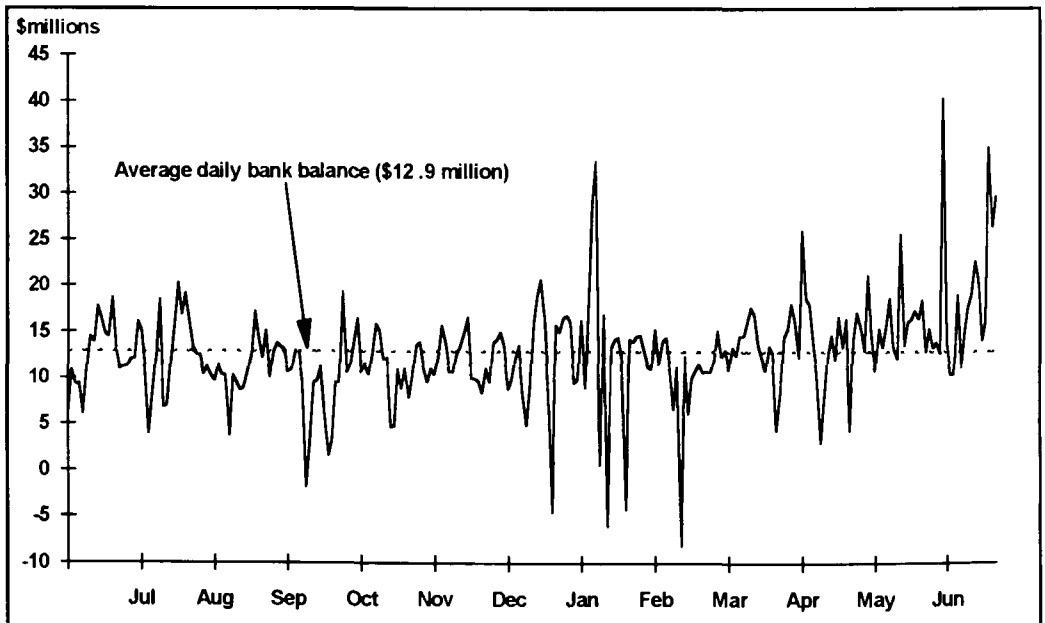
The Department of Finance proposes to forward a copy of the monitoring report on cashflow projections to departmental Secretaries with a view to improving cashflow management performance and reducing borrowings or increasing investments.

Departmental bank balances

3.7.34 Guidelines issued in December 1992 by the Department of Finance to all departments require that advance account bank balances should be maintained as close as possible to a nil balance at the end of each day. In addition, although not stipulated in the guidelines, revenue account balances are to be transferred to the Public Account at the close of business each day.

3.7.35 Chart 3.7D illustrates the daily departmental bank balances during 1992-93, and the volatility in these balances during the year. Total balances ranged from \$40.3 million in June 1993 to an overdraft balance of \$8.1 million in February 1993.

CHART 3.7D
DAILY BANK BALANCES, 1992-93



3.7.36 The chart further shows that, in total, the average bank balance for all departments during 1992-93 was \$12.9 million, of which \$2.6 million related to moneys held in trust and not payable into the Public Account.

3.7.37 The remainder of the departmental bank balances comprised advance and revenue account balances. The advance account balances were largely attributable to inaccurate cashflow forecasts. The funds held in the revenue bank accounts should have been transferred to the Public Account on a daily basis to assist in the reduction in the level of short-term borrowings. The audit review identified numerous instances of delays in clearing such balances to the Public Account. Table 3.7E provides examples of revenue held by entities for extended periods.

TABLE 3.7E
DELAYS IN TRANSFERRING REVENUE TO THE PUBLIC ACCOUNT

Organisation	Period held	Days held	Amount
			(\$m)
Department of Water Resources (a)	5/8/92 to 17/8/92	13	2.7
Liquor Licensing Commission	14/1/93 to 25/1/93	12	3.0
Liquor Licensing Commission	7/9/92 to 14/9/92	8	1.0
Department of Conservation and Natural Resources	31/8/92 to 6/9/93	7	1.0

(a) Now forms part of the Department of Conservation and Natural Resources.

3.7.38 While it is recognised that market rates of interest are payable on all bank account balances, the failure to remit government revenues and excess funds to the Public Account on a timely basis results in additional costs being incurred, as the Government is required to borrow in excess of its requirements. Although the Department of Finance has a bank account management system in place to monitor bank account balances, it has been unsuccessful in persuading individual departments to remit excessive balances to the Public Account.

□ RESPONSE provided by Comptroller-General

The Department of Finance continually advises departments of their bank account balances. Departments must implement procedures to better manage the transfer of moneys to the Public Account. The Department of Finance has no authority to transfer the money.

Utilisation of electronic funds transfer facilities

3.7.39 Banks which service the Public Account and departmental accounts provide a range of products, including electronic banking facilities. Two of the most common electronic banking services offered by banks are direct credit and debit facilities. Direct credit facilities enable payments to be made direct to payee bank accounts in preference to payments by cash or cheque. Direct debit facilities enable funds to be transferred directly to government from client bank accounts.

3.7.40 As direct credit facilities are most effective for regular payments, they are ideally suited for many departmental payments, such as payment of salaries, grant instalments and periodical contract claims.

3.7.41 On the other hand, the use of direct debit facilities by departments has been less popular in the past due to the need to obtain customer authorisation to debit bank accounts, and the fact that the State's major revenues, such as State taxes, are not collected through conventional billing methods. The use of direct debit facilities is gaining momentum in the government business enterprises, where incentives such as eligibility for draws for free holidays are being offered for use of such facilities.

3.7.42 Advantages arising from the use of electronic funds transfer facilities include:

- lower bank transactions fees;
- simplified bank account management;
- improved accuracy in cash forecasting; and
- substantial savings from a reduction in administration costs associated with processing transactions.

3.7.43 In order to maximise the benefits to the State from these banking facilities, the Department of Finance, in conjunction with other departments, should ensure their optimum utilisation. Specific guidelines on the application and potential savings arising from direct debit and credit banking facilities need to be developed and issued by the Department of Finance for guidance to departments.

3.7.44 Audit discussions with one of the banks indicated that scope exists for more effective utilisation of direct debit facilities by departments, with savings of up to \$7 per transaction resulting from the adoption of such facilities.

3.7.45 **The Department of Finance should encourage the extended use of electronic funds transfer facilities by departments and initiate appropriate measures for the adoption of these facilities where savings can be achieved.**

□ RESPONSE provided by Comptroller-General

The Department of Finance will pursue opportunities, over and above those already in place, for the utilisation of electronic funds transfer. Until electronic data interchange is available the scope for improvement in this area is limited.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

DEPARTMENT OF FINANCE

<i>Ministerial Portfolios, May 1993, pp. 125-6.</i>	Need to establish effective strategic management of the budget sector motor vehicle fleet.	The Vehicle Management Division was established within the Department in January 1993 to assist in the strategic management of the budget sector motor vehicle fleet and to provide advice to agencies on strategic fleet management issues.
<i>Ministerial Portfolios, May 1993, pp. 127-9.</i>	Need to finalise and implement enhanced vehicle management arrangements to optimise benefits and minimise costs accruing to the State arising from existing inefficiencies.	The Division has developed central monitoring arrangements in relation to agency vehicle acquisitions, disposals and utilisation. In addition, a private vehicle fleet manager has been appointed to manage a substantial part of the budget sector fleet for a trial period of 12 months ending 30 June 1994.
<i>Ministerial Portfolios, May 1993, pp. 129-30.</i>	Adequate management information systems were not maintained by VicFleet to facilitate the effective monitoring of vehicle fleet operations.	The Division has developed a comprehensive asset register which is used to monitor the operations and size of the budget sector fleet.
<i>Ministerial Portfolios, May 1993, pp. 131-2.</i>	Scope existed for the rationalisation of the fleet as around 30 per cent of vehicles examined by audit were utilised less than the minimum benchmark established by VicFleet.	The Division has reduced the size of the vehicle fleet by 15 per cent since May 1993. Procedures have also been implemented relating to the authorisation of vehicle acquisitions to ensure appropriate justification for their purchase.
<i>Ministerial Portfolios, May 1993, pp. 134-5.</i>	Until current and future government vehicle needs are determined, public funds will continue to be wasted due to the existence of excessive vehicles within the fleet.	Refer to above comments.
<i>Ministerial Portfolios, May 1993, pp. 135-7.</i>	A large proportion of budget sector vehicles were retained past their optimum economic life, adversely impacting on the level of maintenance costs incurred and future changeover costs.	The vehicle fleet rationalisation outlined above was specifically targeted to older vehicles. The Division's information system also identifies vehicles exceeding their optimum economic life, to enable follow-up action with relevant agencies.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED - continued

DEPARTMENT OF FINANCE - continued

<p><i>Ministerial Portfolios, May 1993, pp. 139-41.</i></p>	<p>The lack of adequate business planning and sales and marketing strategies contributed to the State Supply Service only capturing a small component of the total public sector market for the services it provides.</p>	<p>The Department of Finance has completed a detailed review of purchasing and central contract arrangements, including the role and functions of the State Supply Service. The findings and recommendations arising from that review were recently endorsed by the Government.</p> <p>An implementation program is being developed to enable a range of reforms to be in place by December 1995. These reforms include further devolution of the supply and tendering functions to departments, establishment of a new Government Purchasing Board and legislative changes to support the new purchasing framework. The future role of the State Supply Service will be reflected in the implementation of the above reforms.</p>
<p><i>Ministerial Portfolios, May 1993, p. 141.</i></p>	<p>Action needs to be taken to increase the awareness of public sector bodies of the cost competitiveness of the State Supply Service to ensure that the optimum benefits are realised.</p>	<p>Refer to above comments.</p>
<p><i>Ministerial Portfolios, May 1993, p. 142.</i></p>	<p>The State Supply Service needs to investigate the viability of establishing longer-term supplier contracts to ensure that products are purchased at minimum cost.</p>	<p>The Service has established long-term supplier contracts where considered appropriate.</p>

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS				
FINANCE				
Department of Finance	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	27 Oct. 1993	29 Oct. 1993
Coal Mine Workers' Pensions Fund	30 June 1993	No date specified. <i>Coal Mines (Pensions) Act 1958, s.128.</i>	23 Nov. 1993	25 Nov. 1993
Emergency Services Superannuation Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i> Extension granted to 30 Nov. 1993.	3 Nov. 1993	4 Nov. 1993
Government Employee Housing Authority	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	27 Sept. 1993	28 Sept. 1993
Holmesglen Constructions Superannuation Plan	30 June 1993	No reporting requirements. Audit conducted at request of Treasurer.	22 Nov. 1993	25 Nov. 1993
Hospitals Superannuation Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s. 9.</i> Extension granted to 30 Nov. 1993.	16 Sept. 1993	6 Oct. 1993
Local Authorities Superannuation Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i> Extension granted to 30 Nov. 1993.	4 Oct. 1993	12 Oct. 1993
Parliamentary Contributory Superannuation Fund	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i> Extension granted to 30 Nov. 1993.	24 Nov. 1993	25 Nov. 1993
State Casual Employees Superannuation Fund	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i> Extension granted to 30 Nov. 1993.	25 Nov. 1993	29 Nov. 1993
State Employees Retirement Benefits Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i> Extension granted to 30 Nov. 1993.	12 Nov. 1993	15 Nov. 1993
State Superannuation Fund	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	22 Sept. 1993	27 Sept. 1993
Surveyors Board of Victoria	30 June 1993	No date specified. Audit conducted under the authority of the <i>Surveyors Act 1978, s.28.</i>	22 Oct. 1993	26 Oct. 1993
Transport Superannuation Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i> Extension granted to 30 Nov. 1993.	12 Nov. 1993	15 Nov. 1993

Part 3.8

Health and Community Services

KEY FINDINGS

DEPARTMENT OF HEALTH AND COMMUNITY SERVICES

National Campaign Against Drug Abuse

- The Department has, in the past, failed to adequately lead and monitor the provision of funds from the Commonwealth Government's National Campaign Against Drug Abuse (NCADA) program to alcohol and drug treatment agencies. The Department has recently developed a range of management practices and issued a number of policy documents to improve the operation of the State's alcohol and drug strategy, including the NCADA program. One significant departmental initiative has been the release of a key document entitled *New Directions in Alcohol and Drug Services*, in March 1994, which is intended to recognise past deficiencies and provide for a reformed service system to Victorians in terms of addressing alcohol and drug abuse.

Paras 3.8.15 to 3.8.18

- The Department has failed to establish a mechanism whereby it could be assured that quality alcohol and drug services were available to all clients. Audit found that despite the development of a framework for service delivery in the form of a Code of Practice, the Department had not implemented this framework and the majority of funded agencies were unaware of its existence.

Paras 3.8.48 to 3.8.55

- The Department's method of funding agencies on the basis of past levels of expenditure is contrary to its current policy of unit costing (such as its casemix funding of hospitals) where funding is linked to service outputs and desired outcomes.

Paras 3.8.69 to 3.8.71

- Although there have been 2 national evaluations of the NCADA program, there has been no specific assessment of the effectiveness of its strategies in addressing alcohol and drug abuse in Victoria despite the fact that \$78 million has been expended on the program between 1985 and 1993. Audit therefore could not establish whether this expenditure had been effective or had produced any tangible improvements in the lives of those affected by alcohol and drug related problems.

Paras 3.8.8, 3.8.15 and 3.8.87 to 3.8.90

KEY FINDINGS - continued**Closure of Caloola Training Centre**

- The planning, implementation and monitoring processes employed by the Department during the closure of the Caloola Training Centre were effective in ensuring that the de-commissioning of the Centre occurred within the desired time frame and budget.
Paras 3.8.117 to 3.8.120
- The relocation of approximately 50 per cent of Caloola clients into the community was consistent with the Government's commitment to the de-institutionalisation of people with intellectual disabilities. However, the Department had not introduced ongoing global monitoring procedures to assess the effectiveness of the relocations and the long-term impact of de-institutionalisation on both clients and the community.
Paras 3.8.121 to 3.8.128
- The closure of the Centre led to the downsizing of staff numbers by in excess of 370 employees, which represented around 48 per cent of Caloola's workforce.
Paras 3.8.137 to 3.8.140

Acute hospital infrastructure

- The Department of Health and Community Services has not formulated a long-term strategic capital works plan for the ongoing development of hospital infrastructure to meet the community's future health service needs, despite 2 departmental reviews in the mid-1980s recommending that such a strategy be developed.
Paras 3.8.156 to 3.8.165
- Based on a minimum occupancy rate of 80 per cent, there is scope to reduce the number of acute beds in the public and private hospital systems by 1 119 beds.
Paras 3.8.173 to 3.8.183
- A survey of public hospitals indicated that there was surplus capacity within the existing infrastructure equivalent to the space required to accommodate a further 1 605 acute beds. In addition, there were a number of under-utilised facilities within major public hospitals due to the poor condition of certain buildings.
Paras 3.8.184 to 3.8.189
- There exists significant opportunities for the Department and hospital management to rationalise the current infrastructure within the State's public hospital system to ensure its optimal utilisation. The failure to address the issue of under-utilised infrastructure has resulted in substantial opportunity costs to the State.
Paras 3.8.191 to 3.8.192
- There is an inequitable distribution of beds within the metropolitan area. Any decision to proceed with the Epping development and/or integration of the Heidelberg Repatriation Hospital into the State system or the continuation of existing capital works projects will result in an oversupply of acute bed facilities in the northern metropolitan area.
Paras 3.8.194 to 3.8.203
- At June 1993, 37 of the 51 country hospitals previously recommended for merger or role conversion remain as stand-alone acute hospital facilities.
Paras 3.8.205 to 3.8.212

3.8.1 Four Ministers, namely the Minister for Aboriginal Affairs, the Minister for Aged Care, the Minister for Community Services and the Minister for Health have responsibility for operations within the Health and Community Services sector. These Ministers have collective responsibility for the Department of Health and Community Services.

3.8.2 Details of the specific ministerial responsibilities for public bodies within the Health and Community Services sector are listed in Table 3.8A. These public bodies, together with the Department of Health and Community Services, are subject to audit by the Auditor-General.

TABLE 3.8A
MINISTERIAL RESPONSIBILITIES WITHIN THE
HEALTH AND COMMUNITY SERVICES SECTOR

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Aboriginal Affairs (a)	-
Aged Care (a)	-
Community Services (a)	-
Health	Ambulance Officers' Training Centre Ambulance Services (7) Mental Health Review Board Prince Henry's Institute of Medical Research Optometrists Registration Board Physiotherapists Registration Board Psychosurgery Review Board Public hospitals and nursing homes (142) Royal District Nursing Service Victorian Health Promotion Foundation Victorian Nursing Council

(a) Minister has responsibility for certain functions of the Department of Health and Community Services.

3.8.3 Comment on matters of significance arising from the audit of certain of the above entities is provided below.

DEPARTMENT OF HEALTH AND COMMUNITY SERVICES

NATIONAL CAMPAIGN AGAINST DRUG ABUSE

3.8.4 The consequences arising from the abuse of alcohol and other drugs creates a substantial burden on the community, with a leading health economics study conducted in 1990, estimating that alcohol and drug abuse costs Australia a minimum of \$14.2 billion a year.

3.8.5 In April 1985, the Prime Minister, State Premiers, the Chief Minister of the Northern Territory and the Commonwealth Minister for Territories met at the Special Premiers' Conference to discuss issues related to drug use in Australia. As a result of the meeting the National Campaign Against Drug Abuse (NCADA) was established with the aim of minimising the harmful effects of drugs on Australian society.

3.8.6 Current NCADA policy goals, as set out in the *National Drug Strategic Plan, 1993-97*, are to minimise the level of:

- illness, injury and death associated with the use of alcohol and other drugs,
- drug offences and other alcohol and drug related crime; and
- social disruption and loss of productivity attributed to alcohol and other drugs.

3.8.7 Commonwealth funding for NCADA activities takes 2 forms:

- specific purpose grants provided to the States and Territories on a dollar-for-dollar basis; and
- funds expended on national projects such as the National Drug Offensive advertising campaign.

3.8.8 The Commonwealth has, since 1985, provided a total of \$234 million on NCADA, with 33 per cent (\$78 million) allocated to national projects and the balance (\$156 million) distributed on an equal cost-shared basis to the States and Territories. During the period 1985 to 1993 the Victorian NCADA program has received a total of \$78 million; the Commonwealth and the State each contributing approximately \$39 million with the 1992-93 contribution totalling \$9.2 million.

3.8.9 NCADA was last reviewed in 1991 by a Commonwealth Task Force and the National Drug Strategy was set up to implement the recommendations of the report issued by the Task Force. The acceptance by the Commonwealth and States of the Task Force's recommendation for continued funding for the next 5 years (until 1997) provided program stability and the opportunity for long-term planning for NCADA.

3.8.10 In Victoria, approximately 50 non-profit community agencies, such as the Salvation Army (Bridge Haven Program), the Aboriginal Health Service and the Melbourne City Mission, are funded by the Department of Health and Community Services to implement rehabilitation, treatment and education activities. These agencies play a critical role in the delivery of alcohol and drug services and approximately 50 per cent of NCADA funding at the State level is directed to the agencies annually.

3.8.11 In addition to its contribution to the NCADA funds, the Department also administers and funds, an Alcohol and Drug Services Program, which in 1992-93 amounted to \$18 million.

3.8.12 The responsibility for managing NCADA and other State Government funds associated with alcohol and drug programs in Victoria rests with the Victorian Drug Strategy Unit which consists of 10 staff within the Department. The Unit develops policies, prepares plans for the alcohol and drug strategy in Victoria and allocates funds to government and non-government agencies for the delivery of treatment and rehabilitation programs and education/prevention programs.

3.8.13 In 1990 a *Victorian Code of Practice* detailing operational standards for alcohol and drug agencies was developed and issued to funded agencies. However, not all agencies funded in subsequent years were provided with the Code.

3.8.14 During 1993 audit undertook a review of the Victorian NCADA Specific Purpose Grant to determine whether:

- the Department has utilised NCADA funding to increase the quality and quantity of services in the areas of alcohol and drug prevention, treatment and education;
- the Department has provided sufficient direction to program participants;
- there has been adequate co-ordination of NCADA funded health and law enforcement activities; and
- funded agencies have implemented programs in accordance with the principles established by NCADA.

OVERALL CONCLUSION

3.8.15 The Commonwealth's broad strategy of increasing the quality and quantity of alcohol and drug services has, in audit opinion, only been partially achieved, due largely to the Department not providing adequate direction and co-ordination for the funded health and law enforcement activities in Victoria. Furthermore, the lack of sufficient monitoring of agencies' funded activities by the Department prevented audit from determining whether or not funded agencies implemented programs in accordance with the conditions of the NCADA grant. As a result of the above deficiencies, audit was not in a position to establish whether the expenditure of NCADA funds had been effective or had produced any tangible improvements in the lives of those affected by alcohol and drug abuse. **Accordingly, despite the expenditure to date of approximately \$78 million on the program, the effectiveness of the program in addressing alcohol and drug related problems cannot be positively ascertained.** In particular, the audit revealed that:

- The Department does not allocate NCADA funding on the basis of the effectiveness of services provided by the alcohol and drug agencies;
- The Department's method of funding agencies on the basis of past levels of expenditure is contrary to its current policy of unit costing (such as its casemix funding of hospitals) where funding is linked to service outputs and desired outcomes;
- The Department does not document the rationale supporting funding decisions made at the various steps in the process;
- The extent and scope of funding for additional activities has been limited despite the intention of the program to specifically provide resources for new or expanded programs;
- The Commonwealth/State Agreement underpinning the expenditure of NCADA funding does not include specific objectives and performance indicators for the program. The absence of such performance indicators has hindered the management of NCADA funding at the State level;
- NCADA funding is not identified as a separate program in the State Drug Strategy Plan. Accordingly its effectiveness, in isolation from the State Drug Strategy, cannot be determined;
- The number of alcohol and drug activities funded by NCADA has decreased from 99 in 1988-89 to 76 in 1993-94;
- In 1993, in response to an audit survey, 44 per cent of NCADA-funded alcohol and drug agencies indicated that their alcohol and drug activities had been funded by the State prior to 1985. In other words, NCADA funding had been substantially directed to existing services or activities rather than new or additional activities as envisaged by the Commonwealth;
- Even though a Code of Practice governing the quality of service provision for alcohol and drug agencies had been developed by the Department, compliance with the Code has not been monitored or enforced;
- The Department has not established a reliable alcohol and drug management information system to enable it to make informed decisions on the provision of NCADA funding to agencies; and
- There are few procedures in place to ensure adequate co-ordination of the administration of NCADA funding. The procedures and systems which are in place, are incomplete and do not deliver timely management information.

OVERALL CONCLUSION - *continued*

3.8.16 In an attempt to overcome the above problems, the Department proposes to institute a range of initiatives and has issued a number of policy documents to enhance the effectiveness of NCADA. In particular, the Department has undertaken a review of alcohol and drug services in Victoria and in March 1994 launched its future policy proposals with the document *Future Directions in Alcohol and Drug Services*. This redevelopment plan recognises weaknesses existing in the current program and includes the following measures to address these deficiencies:

- tendering and contracting new regional services;
- developing standards and protocols for service providers;
- reviewing and reforming service agreements; and
- establishing a detailed communication process involving service providers and regional offices.

3.8.17 In addition, the Department needs to:

- define, as a priority, the purpose of NCADA funding;
- develop specific performance indicators and an effective data collection system; and
- actively encourage competition among agencies for NCADA funds, with a view to providing the stimulus to agencies to develop new cost-effective initiatives.

3.8.18 The adoption of these measures, together with departmental initiatives, will provide a sounder basis for the future management of this program.

□ RESPONSE *provided by Secretary to the Department of Health and Community Services*

The Ministerial Council on Drug Strategy, which comprises Commonwealth, State and Territory Ministers for health and law enforcement, oversees the National Campaign Against Drug Abuse (NCADA). NCADA is a major national effort to minimise the harmful effects of drug use on Australian society. Victoria has worked co-operatively with the Commonwealth to achieve this mission. The Victorian and Commonwealth Health Departments consider that Victoria has met the Commonwealth goal of increasing the quantity and quality of alcohol and drug services in Australia.

The Department of Health and Community Services accepts that there have been significant weaknesses in the overall direction and administration of the Alcohol and Drug Program in general, and NCADA funding in particular. These weaknesses have been identified and addressed through significant management improvements introduced as part of the 1993-94 budget process and implemented prior to the advice of the auditor. In addition, the Alcohol and Drug Redevelopment Plan launched by the Minister in March 1994 is a total reform designed specifically to deal with problems of strategic direction, accountability and efficiency.

The total budget of the Victorian Alcohol and Drug Program is \$26.7 million and in 1993-94 NCADA funds accounted for 36 per cent of this amount. It is recognised some of the currently NCADA-funded alcohol and drug agencies had been funded by the State prior to NCADA funding. However, 56 per cent of the NCADA-funded agencies surveyed had not been funded by the State prior to NCADA. The Commonwealth and Victorian Health Departments deem that NCADA funding should and has been used to supplement the State Program.

The National Drug Strategic Plan (NDSP) 1993-97 is the comprehensive Commonwealth/State agreement adopted by Ministers at the April 1993 meeting of the Ministerial Council on Drug Strategy. The document was developed by the National Drug Strategy Committee for the Ministerial Council on Drug Strategy. The document was produced with the co-operation of health and law enforcement jurisdictions representing the Commonwealth and all States and Territories. The NDSP sets out key measurable indicators that will assist in the monitoring of key policy objectives and evaluate the effectiveness of the Strategy. The document assists in the management of the NCADA funding at the State level.

The NCADA funding is not identified as a separate element in the State Drug Strategy Plan. The goals and targets of the National Drug Strategic Plan and the Victorian Drug Strategy (VDS) are common. A number of principles were set down to underpin the NCADA campaign. These included:

- a national approach across jurisdictions;*
- an emphasis on strengthening the capacity of existing structures;*
- a comprehensive approach focusing on those legal and illegal drugs which cause most harm;*
- reliable data and evaluation;*
- an emphasis on demand reduction programs but inter-related with attempts to control supply; and*
- a degree of permanency.*

The VDS reflects the commitment of the Victorian Government to providing leadership and support necessary to reduce the human and economic costs of drug-related problems in Victoria. The VDS represents Victoria's contribution to national efforts to combat alcohol and drug abuse. The Victorian Drug Strategy Statistics Handbook established the baseline indicators against which the progress of the VDS can be measured.

Audit is critical of the reduction in the number of service programs funded by NCADA over the past 2 years. Reducing the number of funded projects was a deliberate policy aim of the Department and has little bearing on the range and level of services provided. The focus of the Victorian Alcohol and Drug Program is on the delivery of services and health outcomes rather than maintaining agencies. The Department has encouraged smaller non-government agencies to merge with local health and community service providers. The decrease in the number of NCADA-funded programs has not resulted in a decrease in service delivery.

The Department recognises that there are cost disparities between agencies and is currently finalising service specifications and protocols to ensure consistent quality of care throughout the State. A significant outcome of the Redevelopment Project has been the formulation of a regional funding formula to redress the past imbalances in regional funding. The formula is based on:

- the size of the population;*
- a socio-economic disadvantage index; and*
- a non-metropolitan weighting to cover higher costs associated with service provision in rural and remote areas.*

The Department will proceed to implement the redevelopment of Alcohol and Drug Treatment Services over the next 2 financial years. At the end of this time, a completely different picture of more accessible, cost-effective, outcome oriented services will be seen in Victoria.

Lack of NCADA objectives and performance indicators

3.8.19 In 1985, when NCADA was established, its stated aim was broadly defined as minimising the harm resulting from the abuse of alcohol and drugs by the adoption of a number of strategies such as improving the quality and quantity of services available at that time to those in need. The Commonwealth did not include specific NCADA objectives in either the 1985 Campaign document or in the *Conditions of Grant* which forms part of the Commonwealth/State Agreement underpinning the NCADA funding.

3.8.20 The lack of stated objectives and measurable performance indicators was raised by the 1991 Task Force which was established by the Commonwealth to evaluate the experiences of the first 6 years of the program and to make recommendations for its future. Major recommendations made by the Task Force included the need to develop specific objectives, performance indicators and strategic plans for NCADA at both the national and State levels.

3.8.21 In June 1993, 8 years after NCADA commenced, Victoria launched its initial strategic plan for the State alcohol and drug program entitled *Victorian Strategic Plan, 1993-1998* which was intended to cover NCADA and other State programs. However, specific NCADA objectives and performance indicators were not identified in the Plan.

3.8.22 The Department advised audit that it considered NCADA to be no different to any other part of the State's alcohol and drug strategy and therefore it did not warrant a separate strategy. However, audit found that the 1993 State-wide alcohol and drug strategy includes only broad performance indicators which do not allow the Department to measure the specific impact of its total expenditure on alcohol and drug services in Victoria, including the provision of adequate accountability to the Commonwealth for NCADA.

3.8.23 In the absence of detailed performance indicators which should be linked to specific objectives, it has not been possible for the Department or audit to assess the effectiveness of the program despite the fact that \$78 million in NCADA cost-shared funding has been expended between 1985 and 1993.

3.8.24 While recognising that a program which has involved expenditure totalling \$78 million over an 8 year period could be considered relatively insignificant in light of the Department's total expenditure over that time, audit nevertheless is of the view that there should have been specific objectives and performance indicators developed for NCADA from its inception to enable evaluation, particularly given the immense social problems the program was meant to address.

3.8.25 In view of the inadequacies of the broad performance indicators contained in the 1993 State-wide alcohol and drug strategy, audit is also of the opinion that the Department needs to examine the issue of performance measurement for the State's entire alcohol and drug program.

3.8.26 In the absence of specific objectives and measurable performance indicators, audit concentrated on reviewing current management practices including compliance with the *Funding Arrangements* and the conditions of grant.

3.8.27 Audit identified a number of significant factors which have also adversely impacted on the delivery of NCADA-funded alcohol and drug services. These are discussed in the following paragraphs.

Factors impacting on the NCADA achievements

Agreements underpinning NCADA

3.8.28 NCADA cost-shared funding is underpinned by different agreements, a Commonwealth/State Agreement and Health Service Agreements between the State and funded agencies. While both agreements include accountability arrangements between the respective parties, audit found a number of deficiencies in each form of agreement. These deficiencies are set out below.

Commonwealth/State Agreements

3.8.29 Commonwealth/State Agreements should clearly set out the purposes for their existence and the objectives expressed as measurable desired outcomes to be pursued to ensure that the rights and obligations of each party are clearly identified.

3.8.30 The current conditions applying to the provision of financial support to NCADA by the Commonwealth Department of Human Services and Health are documented in the *Standard Conditions of Grant to States/Territories and Other Government Bodies (Standard Conditions of Grant)*" and the *National Campaign Against Drug Abuse (NCADA) Cost Shared Arrangements with States Special Conditions* (NCADA Special Conditions).

3.8.31 Audit was advised by the Commonwealth Department of Human Services and Health that the *Form of Acceptance* signed by the States, including Victoria, was deemed to be the Agreement for the purposes of the Special Purpose Payment. However the *Form of Acceptance* and other related documentation did not define the purposes for which the grant moneys were to be utilised, with reliance instead being placed on the interpretation of the NCADA strategy as issued in the NCADA document following the Special Premiers' Conference in 1985.

3.8.32 As a consequence, the program has largely been implemented in Victoria by the various agencies as they have seen fit, due to the absence of clearly defined Commonwealth/State objectives and performance criteria. This situation has contributed to NCADA funds being used by agencies to supplement existing programs as opposed to the broad Commonwealth intention expressed in the NCADA funding arrangements that funds be directed towards the expansion of access and availability to alcohol and drug services.

3.8.33 The lack of objectives and performance measures since NCADA commenced in 1985 was partly addressed by the development of the *National Drug Strategic Plan 1993-1997* commissioned by the Ministerial Council on Drug Strategy which comprises police and health Ministers from each State. The Plan provides an outline of the Campaign's national strategy for the 5 year period including proposed goals and objectives, key indicators, and program priorities for focusing national attention and action in this area.

3.8.34 The "*Victorian Strategic Plan for 1993-1998*" which, together with the proposed annual action plan for 1993-1994, will complement the broad framework outlined in the national plan as it addresses Victoria's priorities and major problem areas.

3.8.35 The current Commonwealth grant conditions for NCADA do not refer to the goals and objectives contained in either the national or State drug plans, and do not include any specific goals and objectives for the NCADA funding.

3.8.36 The State needs to liaise with the Commonwealth to ensure that the goals and objectives of NCADA funding are more clearly defined.

Compliance with NCADA funding requirements

3.8.37 The Commonwealth placed the following conditions, which are also NCADA funding requirements, on the provision of NCADA funding:

- two-thirds of the funding was to be allocated to treatment and rehabilitation activities and the remaining one third to education and prevention activities;
- the State is required to keep records for NCADA funding so that income and the expenditure of NCADA funds can be verified in accordance with the funding conditions; and
- funding was to be provided for new or expanded activities, that is activities not in operation before the commencement of funding under NCADA.

3.8.38 The audit disclosed that:

- the Department has allocated NCADA funding according to the Commonwealth ratio of two-thirds for treatment and rehabilitation activities and one-third for education and prevention activities; and
- the State does comply with the requirement to report separately for NCADA funding but does not place the same requirements on funded agencies. Failure to separately record NCADA income and expenditure at an agency level makes it difficult for the Department to determine whether any additional or expanded services can be directly attributed to the NCADA funding.

3.8.39 Audit undertook a survey of agencies receiving NCADA funding in 1993 to determine compliance with the funding arrangements and **found that 44 per cent of the agencies which responded to the audit survey indicated that their programs were in existence prior to receiving NCADA funding, with 26 per cent of respondents advising of programs in existence for more than 10 years.** In other words, a significant proportion of NCADA funding was used to supplement existing programs.

3.8.40 Strict adherence by the Department to the Commonwealth funding requirements would require the Department, as part of its annual funding submission to the Commonwealth, to explicitly identify programs that are new and programs that are extensions or a continuation of existing programs. The Department does not identify the extent of new and expanded programs as part of its annual funding process and therefore this information was not provided to the Commonwealth. The Commonwealth has not enforced this requirement despite the fact that the Commonwealth Department of Human Services and Health expressed concerns to audit that the Victorian program did not appear to be offering new alcohol and drug activities.

3.8.41 **The Department's failure to fully comply with the Commonwealth's funding requirements has contributed to the non-achievement of NCADA's strategy to create additional services for persons with alcohol and drug-related problems.**

Accountability

3.8.42 The Commonwealth/State NCADA Agreement and *Conditions of Grant* provide certain basic reporting requirements with the State required to be accountable to the Commonwealth by submitting:

- an annual expenditure statement indicating whether the grants have been used for the purpose for which they were provided, and that the agreement conditions have been met; and
- annual reports describing each funded project, including a program description, numbers of staff employed, planned project evaluation, dates NCADA funding commenced and the Federal electorate in which each project is located.

3.8.43 The reports are required to be submitted by a specified date, contain all required information and be accurate. However, audit found that the State had consistently failed to meet the deadlines stipulated by the Commonwealth, despite numerous requests for the required data. Commonwealth Department of Human Services and Health personnel advised audit that the late lodgement of the material had resulted in the information being useless for timely management decision-making at the Federal level.

3.8.44 In audit opinion, the inaction by the Department to ensure that funded agencies provided proper accountability, including timely information on program performance, impacts significantly on the decision-making process in regard to the future funding and direction of NCADA.

Health Service Agreements

3.8.45 Under the *Health Services Act* 1988, the Department requires all funded agencies, including alcohol and drug agencies, to enter into a Health Service Agreement (HSA) for each financial year in which they receive funding. The HSA is intended to serve as an individual agency plan describing the purposes for which funds are to be used and the accountability requirements for the agency.

3.8.46 Each funded agency is required to submit:

- prescribed quarterly statements of agency performance and agreed client data;
- an audited annual statement of all income and expenditure and a balance sheet; and
- standard monitoring and evaluation reports which seek to ensure that:
 - proper records and books of accounts are kept and maintained;
 - the agency and its operations are covered by appropriate insurance; and
 - policies and program objectives reflect the *Victorian Code of Practice*, which details the standards of practice required for alcohol and drug agencies.

3.8.47 Alcohol and drug co-ordinators employed by the Department in the regions are responsible for monitoring of funded agencies, including adherence to the HSA.

Compliance with Health Service Agreements

3.8.48 A review by audit of the extent of compliance by the various agencies with the reporting requirements of the HSA for 1992-93 found the following deficiencies:

- 67 per cent of the annual financial statements were not certified by an officer of the agency;
- 26 per cent of financial statements were not accompanied by an auditor's report;
- 63 per cent of agencies did not prepare a balance sheet;
- 21 per cent did not meet the required reporting deadline; and
- 20 per cent failed to submit the required client data.

3.8.49 Of particular concern was the lack of evidence that regional co-ordinators attempted to enforce accountability requirements where reporting by agencies was deficient.

3.8.50 Interviews with agencies and regional co-ordinators disclosed that funded agencies saw the reporting requirements as a time consuming exercise which had little relevance to their everyday operation. A number of agencies were concerned that they received little or no feedback from the Department once reports were submitted to the region. Regional co-ordinators' perception of their part in the reporting process was that they are only responsible for gathering and passing the information on to the Department of Health and Community Services.

3.8.51 Audit found that the major formal monitoring task undertaken by the regional co-ordinators was a review of the accountability requirements, including the audited financial reports and the quarterly monitoring forms. In the majority of regions, the current practice is that co-ordinators primarily determine, with minimal attention given to the actual data contained in the returns, whether the required forms have been submitted to the regional office on time. None of the 4 regions visited by audit were able to substantiate the verification of the accuracy of the data submitted to the Department. **Regional co-ordinators interviewed indicated that they rely on agencies submitting correct data.**

3.8.52 Furthermore, there was no evidence to suggest that regional co-ordinators had monitored compliance by agencies with the *Victorian Code of Practice*. Audit found that there was widespread ignorance of the Code by agencies and by some of the regional co-ordinators who were supposedly monitoring compliance with the Code. These findings were consistent with those of a consultant engaged by the Department in 1992 to review certain alcohol and drug services in the Ballarat area, including compliance with the Code.

3.8.53 Departmental monitoring of compliance with the HSA is inadequate, does not ensure proper accountability by agencies and results in a situation whereby the Department is unable to draw any conclusions on their economic, efficient and effective application of funds by such agencies. Notwithstanding this situation, agencies have continued to receive funding from the Department irrespective of their performance or compliance with the HSA.

3.8.54 The Victorian Government has acknowledged deficiencies in the accountability of private agencies receiving public funds and has recently provided additional powers for the Victorian Auditor-General to establish whether grants made to non-government organisations are applied economically, efficiently and effectively for the intended purpose.

3.8.55 In the interests of proper accountability, the Department needs to ensure that:

- future funding decisions are linked to the accountability of agencies for funds previously advanced;
- departmental regional co-ordinators effectively monitor compliance by agencies with the *Victorian Code of Practice*; and
- the results of monitoring activities are applied towards future strategies of the drug and alcohol program.

Co-ordination and administration of NCADA funding

3.8.56 The co-ordination and administration of the NCADA funding is complex because of the number of agencies and government bodies responsible for implementation of NCADA-funded activities.

3.8.57 In the Victorian Strategic Plan, announced in June 1993, the Department acknowledged the need for an efficient structure to allow for effective co-ordination between various bodies involved in the delivery of the State Alcohol and Drug Program and has established a new co-ordinating structure with the following features:

- identification of the Department as the leading agency for the implementation of the Plan and the establishment within the Department of an appropriate secretariat;
- decentralisation of the responsibility for monitoring non-government alcohol and drug services from the Alcohol and Drug Services Unit of the Department to 9 regions in an attempt to provide local and integrated responses to issues arising from alcohol and drug use;

- provision of funding for the position of regional alcohol and drug co-ordinators to implement the program at a regional level;
- re-establishment of the Inter-departmental Senior Officers Co-ordinating Committee to co-ordinate activities undertaken by individual departments for alcohol and drug issues;
- identification of key agencies in the government and non-government sectors to take leading roles in specific areas such as information, research, training and where appropriate, specific drug issues; and
- establishment of improved linkages between groups with related responsibilities.

3.8.58 Although the Department recently recognised the importance of an efficient organisational structure as a co-ordinating mechanism, a number of deficiencies in the current structure remain to be rectified if effective co-ordination of the NCADA funding at the State level is to be achieved. Examples of such deficiencies are outlined below.

Continuous staff changes

3.8.59 Since the inception of NCADA there has been continuous turnover of staff in key management positions largely due to organisational changes within the Department. During the period 1985 to 1994, 7 different individuals have occupied the position of State Manager of the Alcohol and Drug Program with 3 changes occurring during the past 12 months.

3.8.60 The adverse effect of key staff changes on the stability of the Program's leadership was raised repeatedly during discussions at the Commonwealth, regional and agency levels, a consistent comment being the difficulty in determining who was administratively responsible for the Program.

Procedures to link program operations

3.8.61 The existing procedures to link program operations between the agency, regional and departmental levels and ensure that NCADA-funded activities at the various levels are conducted in a manner which will achieve the overall NCADA goals are inadequate.

3.8.62 While the Department has delegated the role of monitoring agency expenditure to its respective regions, there is no requirement for regions to advise of the outcome of their monitoring activities, which are, as previously mentioned, of a poor standard.

3.8.63 **The Department's ability to make informed management decisions is inhibited by the lack of reporting mechanisms linking the Department and its regional operations.**

Provision of NCADA funding to law enforcement agencies

3.8.64 The involvement of law enforcement agencies was seen by the Commonwealth to be integral to NCADA, particularly in the areas of prevention and detection of drug abuse and related behaviour.

3.8.65 **Audit found that NCADA funding was not allocated to law enforcement activities between 1985-86 and 1991-92, a period during which approximately \$60 million was expended in Victoria.**

3.8.66 In June 1990, the Ministerial Council on Drug Strategy re-affirmed an integrated law enforcement/health approach to overcoming the harm caused by the abuse of drugs. It was agreed that the Commonwealth, States and Territories should immediately review existing NCADA allocations and provide adequate funds for law enforcement initiatives with special regard to supply control and problem prevention proposals from 1990-91. The Victorian Government and the former Health Department Victoria, however, took no action to comply with these decisions, **a situation which arose due to a lack of co-ordination between health and law enforcement agencies in Victoria.**

3.8.67 In April 1992, the Ministerial Council on Drug Strategy resolved that each Australian State and Territory should move towards applying a maximum of 10 per cent of NCADA funds to support law enforcement projects over the following 3 years. In accordance with this resolution, \$285 000 of NCADA cost-shared funds were allocated to fund Victorian law enforcement projects in 1992-93. The following areas of law enforcement were among those considered by the Department of Justice as eligible for funding :

- *road safety;*
- *alternative criminal justice approaches to drug offences and offenders;*
- *evaluation of supply control measures on the prevalence of alcohol and drug use, and the negative community consequences of such use; and*
- *review and enhancement of confiscation of assets legislation.*

3.8.68 Although the Inter-departmental Senior Officers Co-ordinating Committee was re-established in April 1992, it was not until March 1994 that an agreement was signed between the Department of Justice and the Department of Health and Community Services detailing the Department of Justice's responsibilities in administering NCADA funding to law enforcement agencies.

□ RESPONSE *provided by Secretary for the Department of Justice*

Arrangements have been made to improve the collaboration between the Department of Health and Community Services and the Department of Justice in the administration of the NCADA program, including a strengthening of the funding process.

Allocation of NCADA funds

3.8.69 In addition to administering the NCADA program, the Government also funds its own alcohol and drug program in Victoria which is generally provided to State-operated agencies such as Heatherton Hospital and the Pleasant View Campus of Drug Services Victoria. While approximately 50 per cent of NCADA funding is directed to non-government alcohol and drug agencies, such agencies may also receive a combination of funding from both NCADA and the State Alcohol and Drug Program.

3.8.70 The Department has chosen to use the same historical basis for allocating NCADA funding as it does for its State Alcohol and Drug Program, that is, past levels of expenditure rather than measured outputs.

3.8.71 Audit found the following deficiencies in the departmental process for the allocation of NCADA funding, particularly to non-government agencies:

- the Department does not allocate NCADA funding on the basis of the effectiveness of services provided by the alcohol and drug agencies;
- the Department's method of funding agencies on the basis of past levels of expenditure is contrary to its current policy of unit costing (e.g. casemix funding of hospitals) where funding is linked to service outputs and desired outcomes;
- the current method of allocating funds does not encourage the development of innovative and additional services in accordance with the Commonwealth NCADA funding arrangements;
- the allocation of funds can take up to 6 months into the next financial year, creating uncertainty for funded agencies, inhibiting their ability to effectively plan programs and forcing them to operate on an ad hoc basis until final funding levels are determined; and
- the Department does not document the rationale supporting funding decisions made at the various steps in the process.

Use of NCADA funding

3.8.72 In 1993-94, State funding for alcohol and drug services was cut by 3 per cent. The resulting shortfall in funding for some agencies appears to have been met from funds provided by the Commonwealth which, in audit opinion, defeats the primary purpose of NCADA to encourage agencies to develop new initiatives addressing drug and alcohol abuse.

3.8.73 Table 3.8B contains examples of the supplementation of the State Alcohol and Drug Program by NCADA grants to funded agencies for the years 1992-93 and 1993-94.

**TABLE 3.8B
MOVEMENT OF GRANTS
BETWEEN THE STATE ALCOHOL AND DRUG PROGRAM AND NCADA**

Agency	1992-93		1993-94	
	State	NCADA	State	NCADA
	(\$)	(\$)	(\$)	(\$)
Palm Lodge	299 300	-	200 000	84 800
Buoyancy	158 200	-	50 400	100 000
St. Vincent's Youth Project	20 500	-	9 400	10 000
MARP (Maroondah Alcoholic Recovery Program)	133 000	87 000	59 000	150 000

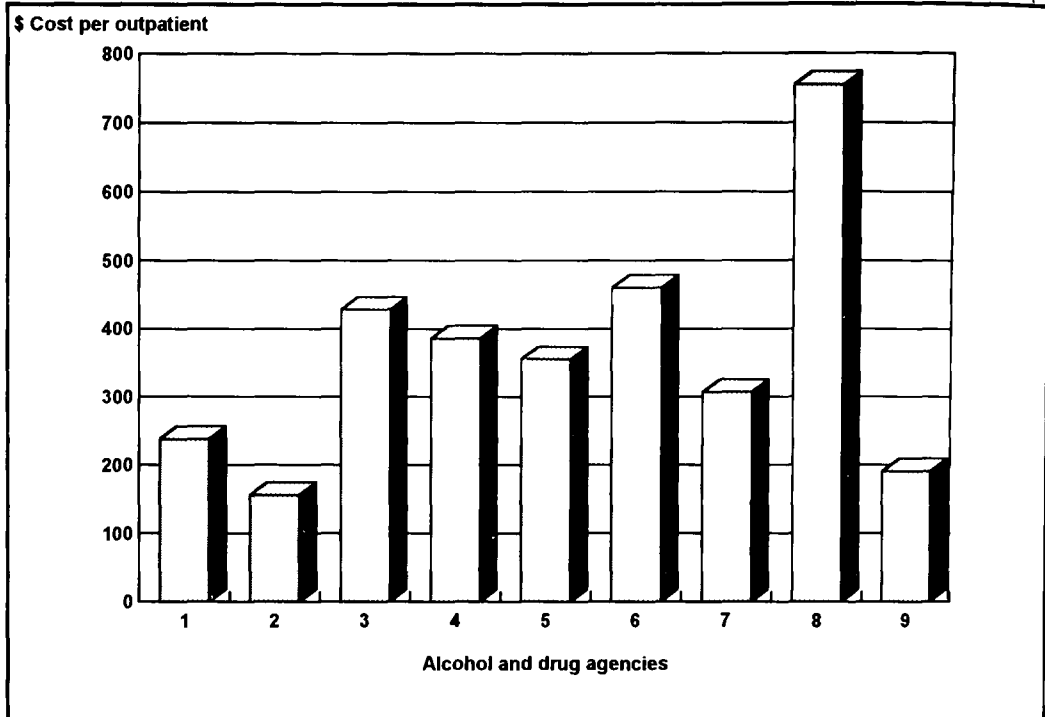
Source: CORE/NCADA Budget, Department of Health and Community Services, 1993-94.

Absence of funding criteria and formula

3.8.74 The Department advised audit that it does not have a funding formula to determine the level of funding allocated to agencies. In the absence of a funding formula, audit conducted an analysis of client services data and the level of funding in respect of all agencies receiving NCADA funding for 1990-91, which was the latest available data.

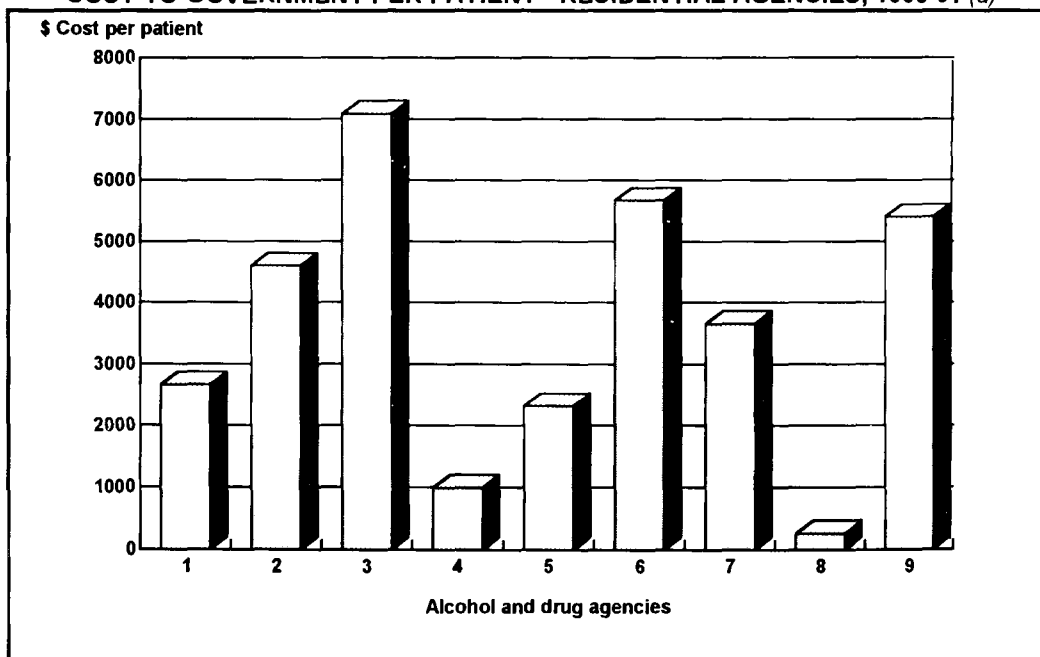
3.8.75 The data on total government funding received and the number of clients seen by the agencies as reported in the agencies' annual reports were used by audit to calculate the unit cost to government of treating a client in each of these agencies. An analysis was made between the cost of treating patients who were residential in NCADA-funded agencies and those who attended as out-patients in non-residential NCADA-funded agencies. The results of this analysis are presented in Charts 3.8C and 3.8D.

CHART 3.8C
COST TO GOVERNMENT PER OUTPATIENT - NON-RESIDENTIAL AGENCIES, 1990-91 (a)



(a) Latest available information.

CHART 3.8D
COST TO GOVERNMENT PER PATIENT - RESIDENTIAL AGENCIES, 1990-91 (a)



(a) Latest available information.

3.8.76 The above charts indicate the wide cost disparities that exist between agencies for both residential, and non-residential care and highlight the need to evaluate the effectiveness, efficiency and economy of each agency's service delivery and to use the resulting information when developing future funding allocations. The wide cost variations between agencies providing similar services was also confirmed by a recent departmental consultancy.

3.8.77 Failure to identify and investigate cost disparities between agencies can result in funding not being directed to the most effective and efficient programs. The wide cost disparities between agencies warrants further investigation by the Department to ensure that scarce resources are being utilised in the most cost-efficient and effective manner.

Target groups

3.8.78 The first campaign strategy for NCADA in 1985 identified women, Aboriginal and Torres Straits Islander (ATSI) people, young people and prisoners as requiring special attention. Injecting drug users and people from non-English speaking backgrounds were also identified as requiring priority attention.

3.8.79 The 1991 Task Force expressed concern at the lack of specialist programs for members of the designated special population groups. The Task Force while recognising the increase in services for women, youth and injecting drug users, called for services that are geographically and culturally accessible, especially in relation to ATSI people and those from non-English speaking backgrounds.

3.8.80 Audit noted that the allocation of NCADA funding by the Department to targeted programs increased from 23 per cent in 1988-89 to 37 per cent in 1993-94. This included a significant increase in funding for youth programs which increased from 9 per cent to 16 per cent over the same period. An increased emphasis on programs for intravenous drug users involving needle exchange facilities was also identified. **These funding allocations indicate that the Department is addressing the needs of these target groups and responses from funded agencies to the audit questionnaire confirm this view. However, targeting of services to non-English speaking background groups remains a low priority for the agencies and the Department. In 1993 the Department commenced a study to determine reasons for this situation.**

Drug and Alcohol Information System

3.8.81 Efficient and effective management information systems are an essential management tool for the Department in fulfilling its planning, monitoring, accountability, evaluation and management roles in respect of NCADA funding.

3.8.82 Prior to the establishment of NCADA, there was no State alcohol and drug-related database upon which reliable estimates of the size of the problems associated with drug and alcohol abuse could be based.

3.8.83 An early NCADA priority was for States to develop their own data collection systems. As a result, the Commonwealth provided funds to each State and Territory to develop an appropriate information system. Victoria developed a computer-based information and reporting system known as the Drug and Alcohol Information System (DAISy) for the non-government alcohol and drug service agencies.

3.8.84 DAISy provides a mechanism for the collection of contact, incidence and admission data from all funded agencies and is centrally processed by the Department. Comparative data and trends over time can be obtained from this database. Agency, regional and State-wide reports are available. These reports are meant to provide management with a range of information on the people utilising the alcohol and drug treatment and rehabilitation services including, the clients' socio-demographic characteristics (marital status, employment status and country of birth), abuse characteristic, period of use and principal problem and service characteristics (referral source and number of registrations for each month).

3.8.85 In discussions with audit, departmental personnel and funded agencies expressed general dissatisfaction with DAISy because it:

- places demands for data recording, but provides limited feedback in the form of reports;
- provides limited analysis or interpretation of data;
- contains data which is not verified by the Department;
- is incompatible with other data collection systems within the Department;
- does not collect, analyse or provide adequate feedback on NCADA target groups;
- does not assist in determining the effectiveness of individual programs or activities; and
- does not have effective links with, or provide information useful for, the development of policy or strategies and hence it is regarded as largely irrelevant by agencies and some regions which have ceased to utilise DAISy.

3.8.86 In light of the deficiencies identified by the users of DAISy, the Department needs to undertake a formal evaluation of DAISy addressing the medium to long-term options and consider implementing short-term strategies to address current serious deficiencies. This would require the regional co-ordinators taking an active role by collecting and screening raw alcohol and drug data from all agencies operating in the catchment area before forwarding the information to the Department for processing, thereby ensuring the completeness, timeliness and validity of the data submitted.

Evaluation of NCADA program

3.8.87 Independent evaluations of the NCADA program were commissioned by the Commonwealth Government in 1988 and 1991. Neither evaluation made specific comments on performance of individual States presumably on the basis that it was anticipated that States would conduct their own evaluations as part of their program planning process relevant to the local situation. If this was the expectation it has not been realised in Victoria, as the Department has not evaluated the State-wide outcomes of the NCADA funding. Discussions with the Department indicated that a process of evaluation at a Statewide level has not been developed.

3.8.88 With no State-wide evaluation of NCADA and the limited evaluation activity undertaken at the agency level, the Department cannot:

- differentiate between effective and ineffective programs;
- establish if public funds are being wasted on ineffective programs; and
- be satisfied that the funded agencies are fulfilling the grant conditions.

3.8.89 Recently, the Department has required the regional co-ordinators to prepare a needs-based planning approach to assist in the determination of funding levels to the regions. This approach has limited use as it collects population data such as the number of alcohol and drug dependent persons in the region rather than specific agency performance data as to the effectiveness of the prevention, treatment and rehabilitation programs utilised by the agencies within the region. The absence of a comprehensive evaluation plan has resulted in the Department not being able to identify the strengths and weaknesses of the program and therefore it is not in a position to initiate program change.

3.8.90 For the Department to develop an evaluation plan for NCADA-funded activities, it needs to define and develop further:

- appropriate reporting systems;
- performance indicators; and
- data collection systems.

Evaluation requirements

3.8.91 The Health Service Agreements entered into between the Department and the funded agencies require funded agencies to monitor and evaluate their activities as a condition of continued funding. Specific requirements for evaluation are:

- the provision for internal evaluation be built into every education and treatment rehabilitation program; and
- that the agencies need to demonstrate to the Department that they have in place plans to develop evaluation strategies as part of their on-going program planning process.

3.8.92 Responses by the agencies to an audit survey indicated that the existing arrangements do not guarantee that the requirements for evaluation are met. The responses indicate that:

- agencies, in a majority of cases, do not allocate resources for evaluation;
- current data collection and collation processes do not enable the agencies to obtain feedback from the monitoring systems such as DAISy; and
- agency skill levels in program evaluation needs to be further enhanced.

3.8.93 More specifically, agency evaluation efforts are oriented towards the collection of process data or throughput data such as number of registered clients and treatment sessions, rather than whether the funded activities are effectively providing treatment and rehabilitation for drug and alcohol abuse, as well as educating the community in the consequences of such abuse. There is little evidence that the data collected is analysed or evaluated by agencies.

3.8.94 Less than 25 per cent of the agencies responding to an audit request were able to supply documented evidence of evaluation activities undertaken by them. Audit therefore concluded that a substantial number of agencies do not undertake evaluations, possibly because of a lack of expertise or a view that resources could be better utilised on other activities.

3.8.95 An examination of the documents provided by the agencies showed that in a majority of cases where evaluations were undertaken, they were carried out by external consultants. Agencies acknowledge that they lack the technical expertise required to conduct evaluations of their activities. This reinforces the agencies' stated need for access to technical support, ideally from the Department.

3.8.96 Another issue of concern expressed in the consultant's report referred to earlier was that despite the attempts to collect service delivery data, the information was not analysed or used to provide feedback for the agency on its program effectiveness.

3.8.97 **The Department needs to emphasise to the agencies the importance of evaluation not only in improving the quality of service delivery and cost efficiency, but also as the basis for future decisions on continued funding.**

Evaluation skill development

3.8.98 In Victoria during 1991, NCADA funded the development and publication of a document entitled *Evaluate Yourself*. This publication describes a practical step-by-step approach for the evaluation of the alcohol and drug services sector. NCADA also funded workshops on the implementation of evaluation methodology relevant for funded agencies.

3.8.99 An audit survey on the use made of the workshops and the evaluation methodology showed that of those agencies that responded:

- 65 per cent had not attended the evaluation workshop;
- 88 per cent of those who attended reported that they were able to apply the principles of the workshop to their agency's program; and
- nearly 25 per cent of the respondents reported a lack of technical expertise in undertaking evaluation activities.

3.8.100 The importance of adequate evaluation processes needs also to be viewed in the context of the Government's strategy of not providing public sector entities with set levels of financial assistance but to link funding to the levels of output achieved. This strategy was reinforced by the Department in 1993 when it introduced casemix funding for public hospitals, whereby government funding is allocated on the basis of services provided.

3.8.101 Audit considers that there is a similarity between casemix funding and the provision of NCADA grants to agencies. Rather than provide grants on an historical basis to agencies, as referred to earlier in this Report, the agencies should be funded on the outcomes achieved in relation to addressing drug and alcohol issues, with measurement being based on program objectives. **To achieve an outcome-orientated approach for future funding it will be crucial for the Department to ensure that proper evaluation processes are being conducted.**

3.8.102 The NCADA program will also be enhanced through the systematic evaluation of the programs designed to address alcohol and drug abuse. The Department needs to take a more proactive role in ensuring that staff from all agencies receiving NCADA funding become trained in evaluation techniques.

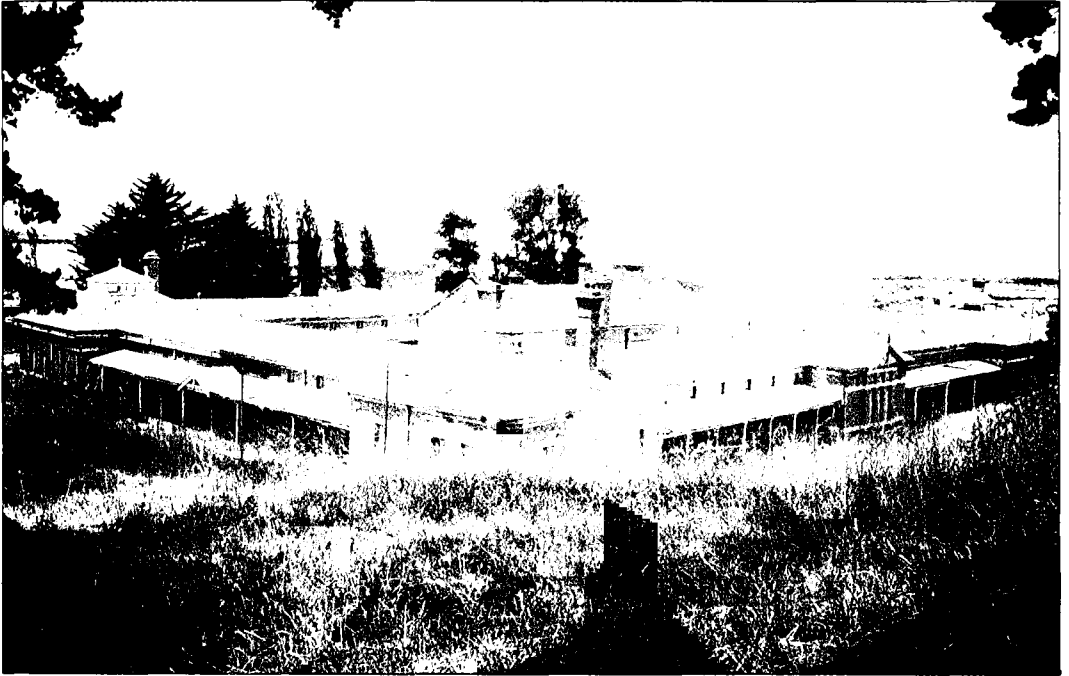
3.8.103 Properly produced evaluation reports should provide valuable feedback to the Department on the effectiveness of agency programs. The lack of use of such reports by the Department means that the Department cannot be assured that NCADA funds are being applied in the most economic, efficient and effective manner.

3.8.104 The Department needs to implement a strategy whereby all agencies are skilled in the production of evaluation reports, with the resultant management information being collated and utilised by the Department in enhancing the achievement of the NCADA aim. The Department also needs to emphasise to agencies that a proportion of the NCADA funding they receive must be applied to the evaluation process.

CLOSURE OF CALOOLA TRAINING CENTRE

3.8.105 The Caloola Training Centre, formerly known as the Sunbury Training Centre for the Intellectually Disabled, was an institution caring for the intellectually disabled which had been in operation since 1879.

3.8.106 The Centre occupied an area of 257 hectares, with the main operating site covering 50 hectares, and included approximately 50 buildings which comprised accommodation units, a church, kitchen, laundry, administration buildings and 18 houses. The houses were initially established for staff accommodation and were later used, in part, to accustom suitable clients to various facets of independent living. The remaining 207 hectares were used for farming purposes and contained a golf course.



The Caloola site, Sunbury.

3.8.107 In 1983, the former Health Commission of Victoria (now the Department of Health and Community Services) formed the view that the Centre's facilities were in an advanced state of decay and recommended that 11 of the 20 accommodation units be decommissioned. A 1991 departmental study estimated that \$63 million would have been required to repair the facilities and create an acceptable living environment for clients if it was to remain fully operational.

3.8.108 The *Intellectually Disabled Persons Services Act 1986* (IDPS Act) established the principle by way of legislation that intellectually disabled persons should have the same rights and entitlements as all other citizens. Following the enactment of this legislation, a plan for the redevelopment of services for the intellectually disabled was completed in 1988 by a consultant engaged by the Department. The plan, entitled the *Ten year plan for the development of intellectual disability services*, was premised on the de-institutionalisation of persons with intellectual disabilities and included a specific recommendation for "... the closure of the Caloola Training Centre as soon as practicable".

3.8.109 Under the IDPS Act, interested members of the community are able to be appointed to a panel known as Community Visitors who undertake regular inspections of residential institutions, including publicly-run Training Centres. The Community Visitors are obliged to review, among other things, the appropriateness and standard of facilities for the accommodation, physical well-being and welfare of clients.

3.8.110 A report prepared by the Community Visitors panel in 1988 criticised the quality of care and service provided to clients located at Caloola. Specifically, the Report stated that *"...the inhabitants of Caloola suffer from isolation, lack of community support, and the lack of a normal existence. They are handicapped by a system that denies the potential of their lives... While they stay at Caloola their development will be crippled by the low expectations that staff and the community have developed. The Centre cannot be salvaged"*.

3.8.111 Caloola had approximately 426 clients and 772 staff, when the Minister for Community Services directed, in August 1991, that a strategy be developed to facilitate the closure of the Centre and the transfer of all existing clients to alternate accommodation within approximately one year. The closure of the Caloola Training Centre was completed by the Department on 31 October 1992.

3.8.112 Audit conducted a review focusing on the management processes implemented by the Department to close Caloola, the strategies adopted to relocate its clients and staff, and the management of the vacant site subsequent to the closure.

OVERALL CONCLUSION

3.8.113 Audit concluded that the planning, implementation and monitoring processes established by the Department to ensure the efficient and effective closure of Caloola within established parameters had culminated in this objective being achieved within budget and the planned timetable.

3.8.114 The closure of the Centre resulted in substantial efficiency gains from the downsizing of staff numbers by in excess of 300 employees, which represented around 48 per cent of Caloola's work force.

3.8.115 The relocation of approximately 50 per cent of clients into the community was consistent with the Government's commitment to the de-institutionalisation of persons with intellectual disabilities. In addition, clients were relocated to a better standard of accommodation than that available at the Centre.

3.8.116 However, it was observed that the Department had not introduced ongoing global monitoring procedures to assess the effectiveness of the relocations and the long-term impact of de-institutionalisation on both clients and the community.

Management of the closure

3.8.117 To facilitate the closure of Caloola by the end of October 1992, the Department established a project team to manage the relocation of clients, the development of alternate accommodation and the redeployment of staff. The majority of members of the project team were drawn from within the Department, supplemented by staff from other government departments.

3.8.118 An appropriation of \$30.8 million was allocated to cover the costs relating to the closure, comprising \$15.8 million for capital works and \$15 million to fund the operation of dual facilities during the period when clients were being progressively moved from Caloola to their new accommodation.

3.8.119 A master plan was developed by the project team to co-ordinate and monitor all facets of the closure process, with sub-teams having delegated responsibility for various functional aspects of the closure such as client relocation and capital works. An overall reporting framework and performance targets were developed, requiring individual team leaders to regularly report to the project team on the status of their designated area of responsibility.

3.8.120 The audit review of the planning, implementation and monitoring processes employed by the Department to ensure that the closure of Caloola occurred within the desired timeframe and budget confirmed that the overall management processes were effective. In particular, all major issues impacting on the closure were identified in the planning phase, appropriate levels of management within the Department were progressively kept informed of the status of the closure and problems which were identified were addressed and resolved as they arose.

Relocation of clients to alternate accommodation

3.8.121 As previously mentioned, when the closure was announced in 1991, Caloola housed 426 clients. The audit review identified that 45 per cent of all Caloola clients were between the age of 40 and 60 years, with 28 per cent over 60 years of age. A detailed review of the histories of 44 of those clients revealed that their average length of institutional residency was 23 years.

3.8.122 As part of the closure process, a project sub-team had responsibility for reviewing each client in order to develop a profile indicating the client's need for support and supervision. This profile was developed taking into account client and parent or guardian preferences for the type and location of alternate accommodation to determine where clients were to reside.

3.8.123 When determining the alternate accommodation, the team adopted the fundamental principal that clients were only to be moved to a level of accommodation that was of an equal or better standard than that at Caloola. If clients, parents or guardians were dissatisfied with the relocation proposal they were entitled to appeal to the Intellectual Disability Review Panel, an independent body established under the IDPS Act.

3.8.124 The audit review identified that:

- 218 clients who had been assessed as capable of living in a community environment were moved to houses within the community which generally accommodated between 4 to 6 clients. Each house is managed by a supervisor who is a departmental employee;
- 165 clients who were assessed as requiring a greater degree of supervision or displayed behavioural problems were transferred to other Training Centres such as Janefield, Kingsbury, Kew Cottages, Pleasant Creek, Sandhurst and Colanda; and
- 43 clients who required a high level of care were moved to nursing homes or hospices.

3.8.125 Approximately 90 per cent of clients were matched to one of their 3 preferences. Clients or their representatives lodged 23 appeals with the Panel against relocation decisions. However, only 6 appeals were heard and, in all cases the original decisions of the relocation team were upheld.

3.8.126 Given the mature age and extensive exposure to institutional life experienced by a high percentage of Caloola clients, the relocation of 51 per cent of clients into the community was consistent with the principal objective of de-institutionalisation of people with intellectual disabilities.

3.8.127 However, audit found that while the Department had established individual client monitoring processes for relocated clients, in accordance with the IDPS Act, it had not introduced ongoing global monitoring procedures to assess the long-term impact of de-institutionalisation not only on relocated clients but also on the community. Such procedures would act as a means of ensuring the development of the most efficient and effective de-institutionalisation strategies for the future.

3.8.128 In light of the magnitude of client relocations, and the planned closure of similar institutions, the Department should supplement its individual client monitoring processes with a global monitoring process for relocated clients.

□ RESPONSE provided by Department of Health and Community Services

The Department will consider a longitudinal study of relocated clients.

Establishment of alternate facilities

3.8.129 New or improved accommodation facilities were required to be established throughout Victoria for the 218 clients assessed as suitable for relocation into the community and the 165 clients transferred to existing Training Centres. The relocation of clients into the community required the purchase of land and the construction of houses or the purchase and refurbishment of existing houses. The refurbishment of institutional units at existing Centres was also required for clients who were to transfer to such Centres.

3.8.130 A project sub-team was formed to plan, co-ordinate and monitor the purchase of land and houses, the building of new houses, and the refurbishment of existing houses and units at 6 Training Centres. The team worked in conjunction with the client relocation sub-team and officers from the Department's regions receiving clients, to ensure that facilities were developed in the appropriate areas.

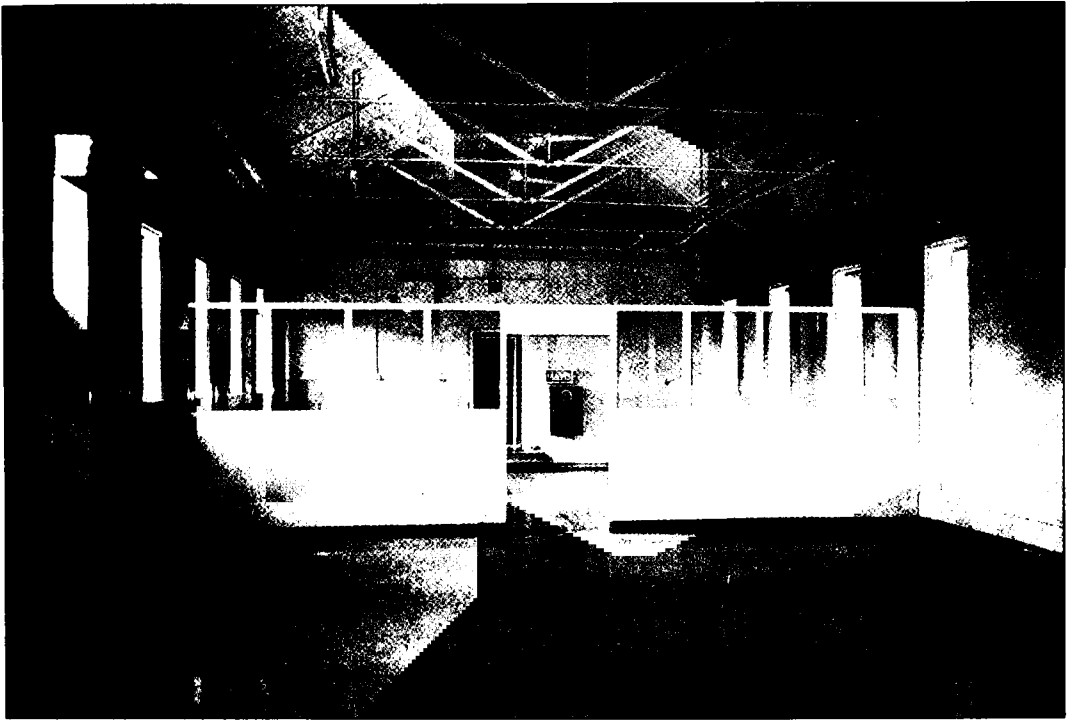
3.8.131 In order to close Caloola, the Department established 43 community houses and refurbished 10 units and 7 on-site houses at 6 existing Training Centres, at a cost of \$15.8 million, including \$1.5 million for furniture and equipment.

3.8.132 The audit review examined departmental records and established that all land acquisitions were based on valuations from the Valuer-General, with the construction of all new houses awarded to private sector contractors following a formal tendering process, and financial and time budgets were adequately monitored throughout the development of these facilities.

3.8.133 Audit inspections confirmed that the new locations and accommodation was of a better standard than that offered at Caloola.

3.8.134 Many of Caloola's buildings, including the accommodation units, were built in the 1880s and as recognised by the Department, their physical fabric could no longer provide acceptable accommodation as many of the buildings posed major health and safety problems.

3.8.135 Audit visited the Caloola site subsequent to its closure and observed outmoded facilities such as steam heating, dormitory-style sleeping accommodation, high ceilings with no insulation, buildings containing asbestos and limited facilities to accommodate clients with physical disabilities.



Style of accommodation offered at Caloola.

3.8.136 Audit also visited several community residential units, 2 nursing homes and several accommodation units at 3 Training Centres used to relocate ex-Caloola residents. The accommodation offered at these locations provided improved comfort and privacy, as well as improved facilities for clients with physical disabilities.



An example of new accommodation provided to ex-Caloola clients.

Downsizing of staff numbers

3.8.137 When the closure of Caloola was announced, it employed 772 staff of which approximately 67 per cent were engaged in direct care activities, such as nursing, and 33 per cent in non-direct activities, such as gardening and cleaning.

3.8.138 A project sub-team was formed with responsibility for counselling staff and administering their redeployment from Caloola. Staff were offered a number of redundancy and employment options, including an Enhanced Resignation Package which was generally available within the Victorian public sector, a specific redundancy package for Caloola employees, re-training for new positions created by the relocation of ex-Caloola clients, and re-training for redeployment within the Victorian Public Sector. A range of programs was also developed to assist staff to cope with their career change and enhance their future job opportunities. Audit found that 700 staff were provided with counselling or re-training.

3.8.139 Departmental statistics disclosed that:

- 349 staff were redeployed either to community residential units, institutional units to which clients had been relocated, departmental regional offices or other State Government departments;
- 371 staff accepted redundancy packages; and
- at the time of the closure, 52 staff who were unable to be redeployed or did not accept a redundancy package, remained as departmental employees. This number has since been reduced to approximately 30 due to subsequent redeployment or acceptance of redundancy packages.

3.8.140 The downsizing of staff numbers by in excess of 370 clearly indicates that substantial efficiency gains have been made as a result of the Centre's closure. The audit review of the procedures followed in the management of ex-Caloola staff concluded that appropriate measures were taken to ensure that a positive result was achieved which benefited both the staff and the Department.

Management of the site

3.8.141 Following the closure of the Centre, the Caloola site was transferred to the control of the Department of Finance on 1 November 1992. To ensure its security, the site has been monitored by a security firm on a part-time basis and an on-site caretaker on a full-time basis. A 2.5 metre high security fence spanning 2.2 kilometres and costing \$60 000 was also erected in June 1993 to secure all historical buildings.

3.8.142 The audit review disclosed that the 18 houses located on the site had largely remained unused since the closure. However, the Department advised that this was due to:

- certain fittings such as baths, heaters, hot water units and air conditioners being removed from the houses and used in the refurbishment of houses at other Centres. In addition, the houses were assessed by the Department of Finance as requiring substantial improvements if they were to be let. The Department estimated it would cost between \$4 000 and \$10 000 to bring each of the houses into a tenable state and did not consider it viable to do so as they may be demolished once the future plans for the site were announced; and
- a 14 month delay in determining the future use of the site. As a consequence, the Department of Finance was unable to enter into any lease agreement due to the uncertainty over the site's future use.

3.8.143 In January 1994, the Premier announced that part of the Caloola site would be refurbished and become the Western campus of the Victoria University of Technology. Details are currently being finalised by the Department of Finance for the transfer of the Caloola site to the Urban Land Authority. Once this transfer occurs, the Authority will transfer approximately 16 hectares, which includes a large number of the principal buildings, to the University. The remaining area will be developed as a residential area for sale by the Authority, with the proceeds to be used to fund the development of the University.

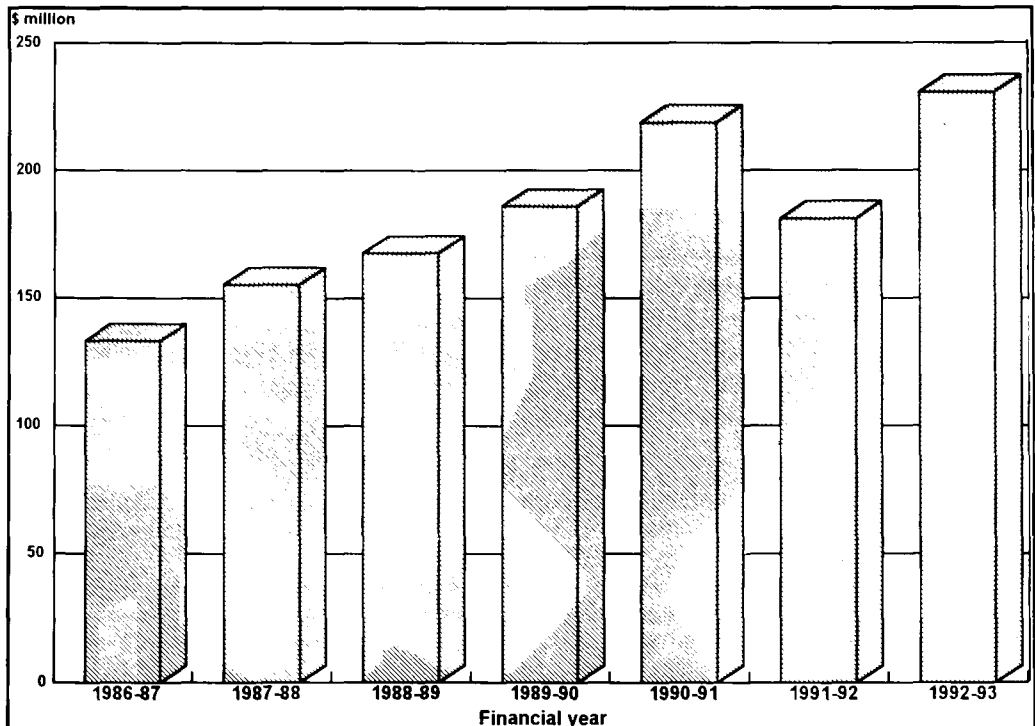
ACUTE HOSPITAL INFRASTRUCTURE

3.8.144 Acute health services within Victoria, such as medical, surgical and nursing activities, are provided by hospitals in both the public and private sector. The public hospital system includes 135 acute hospitals containing 12 100 acute beds (excluding those in geriatric and psychiatric centres), of which 7 800 are located within the Melbourne metropolitan area and 4 300 in country Victoria. The State's private hospital system provides 6 200 beds, with 5 200 located in metropolitan Melbourne and 1 000 in the country.

3.8.145 During the period July 1986 to June 1993, the Department of Health and Community Services undertook major capital works at a cost of \$1.2 billion, aimed at increasing the range of public hospital services available throughout the State. Expenditure on acute public hospital facilities within the Melbourne metropolitan area totalled \$1 billion (82 per cent), while expenditure of around \$230 million (18 per cent) was incurred in country areas.

3.8.146 Chart 3.8E discloses the level of annual expenditure on acute public hospital infrastructure over the above period.

CHART 3.8E
CAPITAL WORKS EXPENDITURE - ACUTE PUBLIC HOSPITALS



Source: Department of Health and Community Services.

3.8.147 During 1993-94, audit conducted a review to determine the efficiency and effectiveness of the Department's strategic planning processes for the overall provision and distribution of acute health services within the State, and to establish the condition and management practices associated with the public hospital system's infrastructure, which houses the State's stock of acute beds.

3.8.148 All hospitals within the public and private sector systems are developed to operate with a prescribed maximum number of acute beds. When assessing the adequacy of the provision and distribution of hospital infrastructure, audit reviewed the utilisation of this capacity but the review did not cover the equipment utilised by hospitals or buildings used by private hospitals.

3.8.149 It should be noted that subsequent references in this Report to hospitals and beds relate to acute hospitals and acute beds.

OVERALL CONCLUSION

3.8.150 While the supply of acute hospital beds in both public and private hospitals within Victoria is controlled by the Department, strategic planning of acute hospital infrastructure over the past 10 years has lacked a long-term focus, even though 2 major departmental reviews identified this deficiency.

3.8.151 Despite a public perception that patient treatment is delayed as a consequence of extended public hospital waiting lists arising from a shortage of beds, audit found an oversupply of around 1 100 beds in both the public and private hospital systems, with the majority located in country areas. Furthermore, significant variations exist in the distribution of beds per head of population between various regions within metropolitan and country Victoria.

3.8.152 In addition, the review found that the State's public hospital infrastructure currently has the capacity to accommodate 1 600 additional beds. This capacity does not take account of infrastructure not currently used as a consequence of its poor physical condition.

3.8.153 Since 1985, the Department has identified 51 public hospitals in country areas for closure, merger, or conversion to nursing homes. However, at June 1993, 37 of these hospitals remained as stand-alone acute hospitals. The review also disclosed that the Department was considering expanding public hospital services in certain metropolitan regions where excess capacity currently exists.

3.8.154 As the Victorian public hospital system is one of the State's key assets, consuming in excess of \$2 billion annually, it is important that a long-term strategic infrastructure planning process be established as a matter of priority to enable the efficient and effective allocation of scarce public health funds. It is pleasing to report that the Department has commenced action in this area by engaging consultants, in late 1993, to review its infrastructure management processes.

3.8.155 Audit recognises that the provision and distribution of acute health services will, in future, be influenced by the implementation of casemix funding principles. The Department maintains that these principles will force hospitals with excess assets to divest themselves of such assets or find alternate funding sources.

Strategic planning

3.8.156 The supply of acute hospital beds in both the public and private hospital systems within Victoria is controlled by the Department through:

- approving and funding the development of acute facilities within the public hospital system; and
- licensing the provision of acute facilities to be operated by the private sector.

3.8.157 The number and distribution of beds in the public and private sectors and their accessibility to the general public are key factors impacting on the efficient and effective provision of acute health care services within the State.

3.8.158 As far back as 1982, the Government recognised the need to develop a strategic focus for the provision of health service infrastructure, to align existing health care services with the demand for such services.

3.8.159 In 1982, the Minister for Health commissioned a working party to prepare a capital works program for the State's public hospital system, including psychiatric and intellectual disability services. The working party produced a report in September 1983 entitled *A Report on the Capital Requirements of Publicly Funded Health Services in Victoria for the Next Ten Years* (known as the McClelland Report). The key findings of the Report included:

- Victoria was supplied with facilities, measured in terms of total available acute non-psychiatric beds in both the public and private systems, at a lavish standard and, generally, there was no support for an increase in the total numbers of such beds;
- there were gross imbalances in the distribution of hospital services within the State; and
- scope existed to reduce the number of hospital beds in the public and private hospital systems by approximately 2 380, or 14 per cent of the State's total bed capacity, based on a minimum occupancy rate of 80 per cent.

3.8.160 Following receipt of the McClelland Report, the Minister for Health in 1983 established a departmental committee, known as the Capital Works Review Committee, to consider the conclusions contained in that Report. The Committee's terms of reference required it to advise Cabinet on those conclusions and to develop a 10 year strategic capital works plan for public hospitals.

3.8.161 In May 1985, the Committee submitted a report to the Minister for Health which found that:

- on the basis of the departmental benchmark of 4.2 acute hospital beds per 1 000 head of population, set in 1979, there was an uneven distribution of health care services throughout Victoria;
- the uneven distribution of such services resulted from the departmental practice of adding new facilities without rationalising existing services;
- 39 public hospitals in the country should be converted to nursing homes, merged with other hospitals or closed; and
- the annual capital works planning process should be undertaken within an overall strategic planning framework.

3.8.162 Following the completion of the Committee's Report, the Minister indicated that any decisions regarding the implementation of its recommendations would be delayed until the Department had reported to the Minister on the implications of such recommendations. However, audit was unable to establish whether any response was provided to the Minister by the Department regarding the implications of these recommendations.

3.8.163 The audit review found that, subsequent to the McClelland Report and the Capital Works Review Committee Report, the Department had not formulated a long-term strategic capital works plan for the ongoing development of hospital infrastructure. While it is recognised that since 1985-86 the Department has had in place a 3 year rolling capital works program for the public hospital system, this program had been developed in the absence of any State-wide long-term strategic focus.

3.8.164 Audit envisaged that the development of a State-wide strategic plan for health service infrastructure should take into account the:

- size, distribution and demographic structure of the State's population;
- trends in hospital admission rates;
- impacts of advances in medical technology and improved treatment methods on patient length of stay;
- distribution and location of public and private health services throughout the State; and
- age and condition of existing public sector infrastructure assets.

3.8.165 The failure by the Department in the past to act on the recommendations of the McClelland and the Capital Works Review Committee Reports has resulted in the loss of a significant opportunity to develop a long-term strategic direction for the State-wide provision of hospital infrastructure which took account of the community's future health service needs.

Current departmental initiatives

Casemix funding

3.8.166 In July 1993, the Government introduced a new system for funding public hospitals, known as Casemix. The system is based on the concept of the Department purchasing from public hospitals medical services for public patients at standardised rates.

3.8.167 The Department has advised that as a consequence of the new system:

- public hospitals will be expected to operate in the most cost-effective manner in the provision of patient services;
- departmental focus will be on service provision to patients and not the utilisation of hospital facilities, such as the supply of beds and occupancy levels;
- hospitals will be required to manage their infrastructure assets in order to minimise costs and maximise revenues by increasing patient throughput;
- opportunities will be provided for hospitals to effectively use any surplus infrastructure to provide extra services to patients which would attract additional funding from the Department; and
- the onus is on hospital management to assess the use of all capital stocks with a view to disposing or transferring any surplus capital resources. The Department will not provide compensation for costs incurred arising from any under-utilisation of infrastructure.

3.8.168 In addition, the Department indicated in its June 1993 publication *Casemix Funding for Public Hospitals - Victoria's Policy* that during 1993-94 it will examine the appropriateness of incorporating capital funding into the casemix system. It is proposed that a major discussion paper will be developed relating to strategic capital management which will address, among other things, the cost of capital assets as part of the total cost of the provision of hospital services.

Consultancies

3.8.169 In recognition of the on-going deficiencies in the strategic planning of capital works the Department engaged 2 consultants in late 1993 to assist in the development of enhanced capital management practices for the Victorian public hospital system.

3.8.170 One of the consultancies involves the development of a model which will enable the Department to assess the future need for hospital services and to determine the optimal location for health services. The model will initially concentrate on the Melbourne metropolitan area, Geelong and the Latrobe Valley.

3.8.171 The second consultancy aims to survey Victorian public hospitals to obtain information relating to capital asset stocks. The key objective of this consultancy is, to some extent, similar to the objectives of this audit, namely to provide a comprehensive analysis of the existing distribution of, and future need for, public hospital infrastructure including buildings, plant and equipment. The consultant will also be required to, among other things:

- determine the age profile of hospital buildings, plant and equipment;
- develop measures to determine the optimal use of capital stock in public hospitals, with particular regard to the opportunity costs of unused capacity;
- provide estimates of capital expenditure required over the next 10 years; and
- provide training to selected hospital and regional staff to enable them to more effectively manage the capital planning process.

3.8.172 The latter consultancy is to be undertaken in 2 stages, with 40 public hospitals to be reviewed by June 1994 and the balance by June 1995.

Excess capacity

Oversupply of acute beds

3.8.173 The McClelland Report found that, at June 1982, the number of acute beds in both the public and private sectors totalled 19 405 with an overall occupancy rate of approximately 70 per cent. Furthermore, the Report concluded that a hospital with an average occupancy rate consistently below 80 per cent of available beds had surplus bed capacity and that if all hospitals operated at a **minimum occupancy rate of 80 per cent** there were approximately 2 380 surplus beds within Victoria.

3.8.174 Table 3.8F discloses the total available beds and occupancy rates for the Victorian public and private hospital systems at June 1982 compared with June 1993.

TABLE 3.8F
VICTORIAN HOSPITAL SYSTEM (a),
BED FACILITIES AND OCCUPANCY RATES

Area	June 1982 (b)		June 1993 (c)	
	Total beds (no.)	Average occupancy rate (%)	Total beds (no.)	Average occupancy rate (%)
Metropolitan	12 992	72.4	12 955	77.1
Country	6 413	65.8	5 291	70.1
Total	19 405	70.2	18 246	75.1

(a) Includes public and private hospitals.

(b) Data obtained from the *Report on the Capital Requirements of Publicly Funded Health Services in Victoria for the Next Ten Years, September 1983*, Table 1, p.2.9.

(c) Data provided by the Department of Health and Community Services.

3.8.175 Since the 1982 McClelland Report there has been, as identified in the above table, a reduction in the number of acute hospital beds throughout Victoria of approximately 1 160. However, when comparing the minimum occupancy rate benchmark of 80 per cent with the average occupancy rate in 1993 of 75 per cent, this indicates that there is scope to reduce the number of beds by a further 1 119.

3.8.176 Table 3.8G provides a dissection of beds and associated occupancy rates between the public and private sectors in the metropolitan and country areas at June 1982 and June 1993.

TABLE 3.8G
VICTORIAN HOSPITAL SYSTEM BED NUMBERS (a)

Sector	June 1982 (b)		June 1993 (c)		Movement in beds
	Acute beds	Average occupancy rate	Acute beds	Average occupancy rate	
	(no.)	(%)	(no.)	(%)	(no.)
Public -					
Metropolitan	8 334	78.3	7 766	83.3	(568)
Country	5 386	65.6	4 323	68.9	(1 063)
	13 720	73.3	12 089	78.1	(1 631)
Private -					
Metropolitan	4 658	61.7	5 189	67.9	531
Country	1 027	66.9	968	75.5	(59)
	5 685	62.7	6 157	69.1	472
Total metropolitan	12 992	72.4	12 955	77.1	(37)
Total country	6 413	65.8	5 291	70.1	(1 122)
Total	19 405	70.2	18 246	75.1	(1 159)

(a) Includes public and private hospitals.

(b) Data obtained from the *Report on the Capital Requirements of Publicly Funded Health Services in Victoria for the Next Ten Years, September 1983*, Table 1, p.2.9.

(c) Data provided by the Department of Health and Community Services.

3.8.177 The audit analysis found that between the 2 periods, beds in private hospitals in the metropolitan area increased by 531. This contrasts with a decline in beds in public hospitals in the metropolitan area of 568. In addition, beds in country public hospitals decreased by 1 063.

3.8.178 Audit established that the excess capacity of 1 119 available beds within the State at June 1993 mainly relates to private hospitals in the metropolitan and country areas, and public hospitals located in the country.

3.8.179 However, as indicated in its September 1992 health policy, the Government is seeking to improve the balance between the public and private hospital systems by having compensable patients, such as patients on WorkCover, being treated in the private system. In addition, the policy statement indicated that the Government would work with the private sector to provide new or upgraded facilities or technology and enter into arrangements for the use of the facilities or technology by public patients. As a consequence of the implementation of these initiatives, it is likely that private hospital occupancy rates will improve at the expense of the public hospital system.

3.8.180 A further measure used by the Department to determine the adequacy of the supply of beds within the State is the ratio of beds per 1 000 head of population. In 1986, the Department reviewed this ratio and reduced it from a level set in 1979 of 4.2 to 3.9.

3.8.181 Table 3.8H discloses the supply of beds per 1 000 head of population as at June 1982 compared with June 1993.

TABLE 3.8H
BED RATIO, METROPOLITAN AND COUNTRY AREAS (a)

Area	June 1982	June 1993
Metropolitan	4.7	4.0
Country	6.1	4.3
State-wide	5.1	4.1
Benchmarks (b)	4.2	3.9

(a) Includes public and private hospitals.

(b) Benchmarks set by the Department of Health and Community Services.

3.8.182 Over the period June 1982 to 1993, the number of beds per 1 000 head of population reduced from 5.1 to 4.1 on a State-wide basis, which still exceeds the benchmark established by the Department, and therefore indicates an oversupply of beds in public and private hospitals of approximately 900 beds. This compares with an oversupply of 1 119 beds based on the 80 per cent occupancy benchmark. The continued oversupply of beds in Victoria has arisen, in part, as a consequence of the Department's failure in the past to develop and implement a strategic approach to infrastructure development.

3.8.183 The current departmental consultancy into capital asset planning should address the issue of oversupply of beds within the State, including the optimal mix of acute beds within the public and private hospital systems.

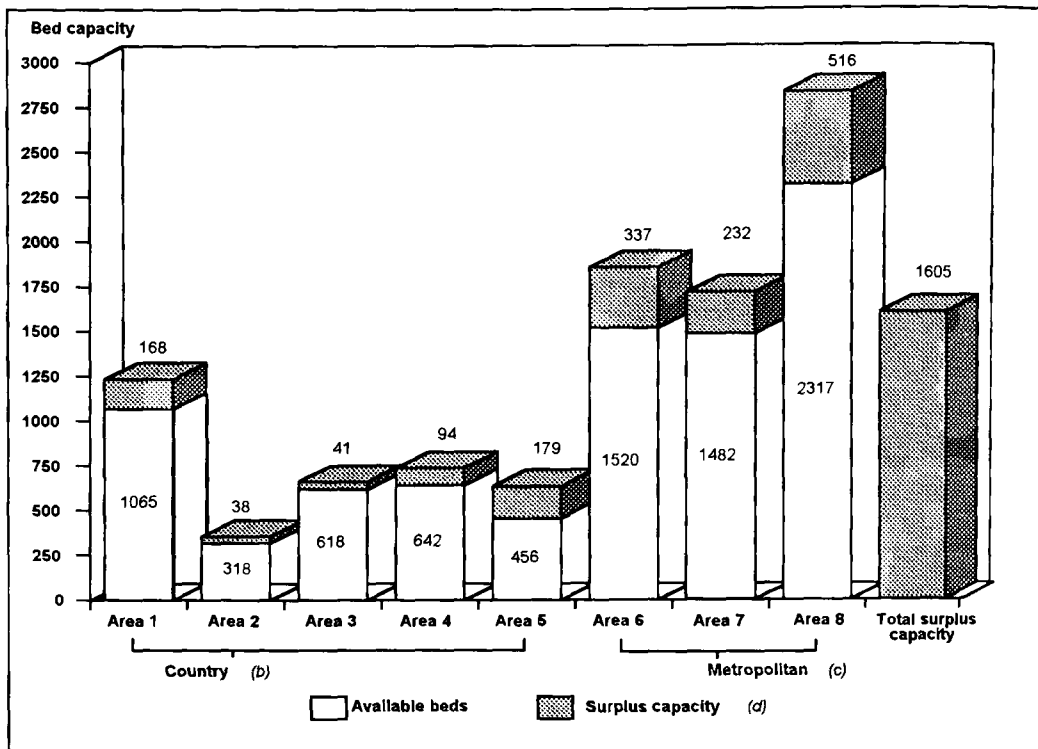
Excess space in the public hospital system

3.8.184 In order to establish whether individual hospitals within the State's public hospital system were maximising the use of infrastructure established for acute beds, audit surveyed all public hospitals to identify at June 1993:

- the number of available beds at each hospital; and
- the maximum bed capacity for each hospital.

3.8.185 Chart 3.8I shows the excess capacity within the 101 public hospitals that responded to the survey. The majority of non-respondents to the survey were small rural hospitals which would not have had a significant impact on the conclusions drawn from the survey.

CHART 3.81
AVAILABLE BEDS COMPARED WITH MAXIMUM BED CAPACITY (a), AT JUNE 1993



(a) Maximum bed capacity equates to the official bed design limit of hospitals according to their advice at June 1993.

(b) Country areas include: Area 1 - Barwon, Glenelg; Area 2 - Central Highlands, Wimmera; Area 3 - Mallee, Loddon-Campaspe; Area 4 - Goulburn, Upper Murray; Area 5 - East and Central Gippsland.

(c) Metropolitan areas include: Area 6 - Western, North Western; Area 7 - Northern, North Eastern; Area 8 - Inner Southern, Peninsula, South East.

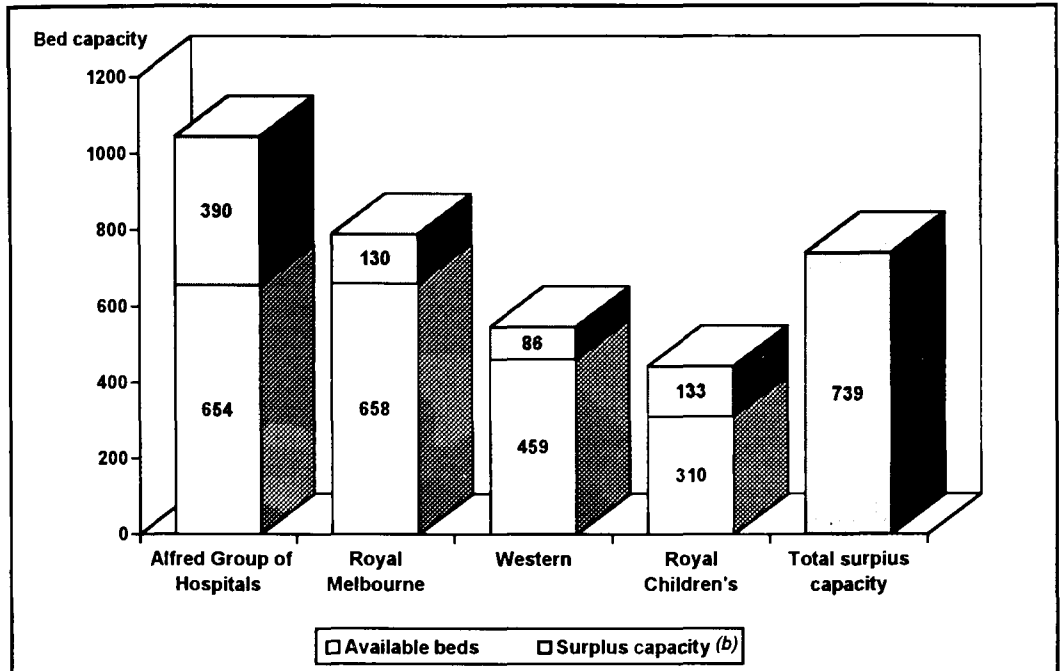
(d) The numeric presentation of surplus capacity represents the area required to accommodate an acute bed.

3.8.186 The survey indicated that there was surplus capacity within the existing infrastructure as there was scope to accommodate a further 1 605 beds, comprising 520 in country areas and 1 085 in the metropolitan area.

3.8.187 As the survey results highlighted substantial potential excess capacity within the metropolitan area, audit undertook a review of 4 major metropolitan hospitals located in close proximity to the Melbourne central business district to ascertain the extent, if any, of under-utilised infrastructure within these hospitals.

3.8.188 The review indicated that there was surplus capacity within the existing infrastructure as there was scope to accommodate a further 739 beds, which is greater than the total number of available beds in any of the 4 hospitals. Chart 3.8J highlights the total surplus capacity in these hospitals.

CHART 3.8J
AVAILABLE BEDS COMPARED WITH THE HOSPITAL'S
MAXIMUM BED CAPACITY (a), AT JUNE 1993



(a) Maximum bed capacity equates to the official bed design limit of the hospitals according to their advice at June 1993.
(b) The numeric presentation of surplus capacity represents the area required to accommodate an acute bed.

3.8.189 While the survey identified significant surplus capacity within the State's public hospital system based on the official bed design limits advised by the hospitals at June 1993, it is acknowledged that some of this space is currently being utilised for other purposes, such as the provision of allied health services, like occupational therapy, and administration.

Additional under-utilised infrastructure in the public hospital system

3.8.190 Further to the previously identified oversupply of acute beds and surplus capacity, there is additional infrastructure within the public hospital system which is not being currently utilised mainly due to the fact that it is not in a condition suitable for current hospital purposes. In the 4 metropolitan hospitals visited during February 1994, audit observed the following under-utilised infrastructure:

Royal Children's Hospital

- 2 floors of a 7 storey building are vacant. The hospital estimates that it will cost \$10 million to upgrade the whole building to an adequate standard; and
- A building of approximately 2 000 square metres is currently vacant due to budget constraints. The hospital has advised that the building will be re-opened later in the year.



Royal Children's Hospital - Vacant building.

Royal Melbourne Hospital - Essendon Campus

- A significant proportion of the area dedicated for administration and support services, such as pathology, within the Essendon campus is not utilised due to these functions being currently undertaken at the hospital's Parkville campus. The hospital has advised that plans are currently being established to re-develop the administration area.

Alfred Group of Hospitals - Alfred Campus

- A 3 storey building, formerly used to accommodate up to 80 nurses, is vacant and in a run-down condition (this matter has been previously brought to Parliament's attention in *Special Report No. 12, Alfred Hospital, May 1990*); and
- 2 floors of another 3 storey building are vacant, one of which has exposed concrete walls and floors, and no partitioning.



Alfred Hospital - Vacant floor in 3 storey building.

3.8.191 Given the substantial under-utilisation of hospital infrastructure, in the form of excess acute beds, available space exceeding operational requirements for acute services, and under-utilised facilities due to the poor condition of certain buildings, there exists significant opportunities for the Department and hospital management to rationalise the current infrastructure within the State's public hospital system to ensure its optimal utilisation. The failure to address the issue of under-utilised infrastructure has resulted in substantial opportunity costs to the State.

3.8.192 The Department intends to develop benchmarks for the optimal use of capital stocks in public hospitals by June 1995. Particular attention will be directed to the identification of the opportunity costs associated with any under-utilised capacity and a framework will be developed by which the Department can routinely collect this information.

Distribution of acute hospital beds

3.8.193 As part of the audit review, an analysis was undertaken of the distribution of acute beds in the public and private hospital systems in order to establish whether there had been any major changes in their distribution since the review undertaken by the Capital Works Review Committee in 1985. The following paragraphs outline the results of the analysis.

Distribution of acute beds in the Melbourne metropolitan area

3.8.194 As a means of improving the distribution of health care services in the metropolitan area, the Committee recommended specific public sector infrastructure developments, which were subsequently undertaken between 1985 and 1993. These works included:

- the partial relocation of the Prince Henry's Hospital to the Western Hospital in 1990. A new 186 bed facility was developed at the Western Hospital's Sunshine campus at a cost of \$88 million, while part of the Footscray campus was redeveloped at a cost of \$43 million and provided an additional 50 beds;
- the construction of a new wing at the Maroondah Hospital in 1991 added 50 beds at a cost of \$41 million;
- the relocation of the Queen Victoria Medical Centre in 1987 to Clayton as part of the Monash Medical Centre development. Stages 1 and 2 of that development cost \$117 million and provided 164 beds while the Moorabbin campus of the Monash Medical Centre was redeveloped at a cost \$25 million and provided 60 additional beds; and
- the extension of the Frankston Hospital in 1988, which increased its bed capacity by 100 beds at a cost of \$33 million.

3.8.195 Table 3.8K shows the change in the distribution of total public and private beds per 1 000 head of population for the metropolitan area since 1982 together with a projection for the year 2001.

TABLE 3.8K
DISTRIBUTION OF BEDS, MELBOURNE METROPOLITAN AREA

<i>Metropolitan area (a)</i>	<i>Acute beds per 1 000 head of population</i>		
	<i>June 1982</i>	<i>June 1993</i>	<i>June 2001</i>
Western	2.3	2.3	1.9
North Western	6.8	7.4	6.9
Northern	7.7	5.2	5.1
North Eastern	2.0	2.1	2.0
Inner Southern Peninsula	6.8	4.0	4.2
South East	2.6	2.8	2.5
Total	4.7	4.0	3.7
Benchmarks (b)	4.2	3.9	3.3

(a) Areas equate with the departmental sub-regions existing at June 1993.

(b) Benchmarks appropriate for 1982 and 1993 set by the Department of Health and Community Services, and for 2001 stated in the Commonwealth National Health Strategy.

3.8.196 An audit analysis of the distribution of total beds across the Melbourne metropolitan area indicates that the Western, North Eastern and Peninsula areas, which were under-resourced in June 1982, still remain under-resourced at June 1993. This situation has remained despite significant new public hospital infrastructure developments in these areas over the 1980s.

3.8.197 In contrast, the North Western and Northern areas have remained significantly over-resourced since June 1982. Despite this situation, further developments are proposed for these 2 areas in the future.

Proposed Epping Hospital

3.8.198 In 1988, the Government gave an undertaking to build a 100 bed public hospital in South Morang, which is in the Northern metropolitan area. However, the site for the proposed development was revised and land at Epping was purchased in 1993 at a cost of \$3 million. The revised development is to comprise a 300 bed public hospital servicing people in the Broadmeadows and Whittlesea areas.

3.8.199 As the proposed Epping development will service people within both the Northern and North Western metropolitan areas, it is apparent that, based on the figures disclosed in Table 3.8G, this development will add to the already existing oversupply of acute hospital beds in these areas, particularly if existing hospital services within these areas are not rationalised.

Integration of the Heidelberg Repatriation Hospital

3.8.200 The Commonwealth Government announced in 1988 its intention to transfer its repatriation hospitals to relevant State Governments by 1995. In Victoria, the Commonwealth's Repatriation General Hospital is located at Heidelberg, within the Northern metropolitan area. The Repatriation Hospital is situated on a 21 hectare site and is an acute general teaching hospital with around 500 beds, providing a broad range of general and specialised medicine, aged care and diagnostic services.

3.8.201 A 1991 joint Commonwealth/State study found that the integration of the Repatriation Hospital into the State public hospital system would lead to an oversupply of beds in the Northern region. Consequently, the study suggested that there would be scope for rationalisation of services, including the down-sizing and/or closure of the Preston and Northcote Community Hospital (PANCH) or the Fairfield Hospital, and a reduction in bed numbers at the Austin Hospital. However, the Victorian Government has currently committed \$14 million to PANCH, of which approximately \$9 million had already been spent by June 1993.

3.8.202 The Government's 1992 health policy indicates that with the transfer of the Repatriation Hospital into the public hospital system, arrangements would be made for veterans to be treated in private hospitals. However, the Department has advised audit that it was unlikely that the Repatriation Hospital would be integrated into the State public hospital system at this stage, given the concentration of health care services that currently exist within the Northern metropolitan area.

3.8.203 Based on the current distribution of acute beds and population projections, audit concluded that any decision to continue with existing capital upgrade projects, or proceed with the Epping development and/or the integration of the Heidelberg Repatriation Hospital into the State system will result in a further oversupply without a rationalisation of total acute bed facilities in the Northern metropolitan area.

3.8.204 In addition, based on the projected population growth to the year 2001 within the metropolitan area, the under and oversupply of beds in particular regions will continue. As part of the current departmental review the consultant needs to examine the requirements for acute beds within the metropolitan area for the next 10 years in line with the Commonwealth's benchmark of 3.3 beds per 1 000 head of population by the year 2001.

Distribution of acute beds in country Victoria

3.8.205 Table 3.8L discloses the distribution of beds per 1 000 head of population for areas outside the Melbourne metropolitan area since June 1982, together with a projection to the year 2001.

TABLE 3.8L
DISTRIBUTION OF BEDS, COUNTRY VICTORIA

<i>Country areas (a)</i>	<i>Acute beds per 1 000 head of population</i>		
	<i>June 1982</i>	<i>June 1993</i>	<i>June 2001</i>
Barwon	3.8	3.4	3.0
Glenelg	8.0	5.3	5.0
Central Highlands	6.5	5.1	4.3
Wimmera	9.0	6.4	6.3
Mallee	7.9	5.1	4.4
Loddon-Campaspe	6.8	4.6	4.0
Goulburn	5.2	4.2	3.6
Upper Murray	6.5	4.6	4.0
East Gippsland	5.3	3.3	3.2
Central Gippsland	5.9	3.3	2.7
Total	6.1	4.3	3.8
Benchmarks (b)	3.7	3.9	3.3

(a) Areas equate with the departmental sub-regions existing at June 1993.

(b) Benchmarks appropriate for 1982 and 1993 set by the Department of Health and Community Services and for 2001 stated in the Commonwealth National Health Strategy.

3.8.206 The audit revealed that the ratio of acute beds per 1 000 head of population across all country areas has fallen over the period June 1982 to June 1993. However, at June 1993, 7 of the 10 areas had an oversupply of beds compared with the benchmark.

3.8.207 On the basis of population projections to the year 2001, all country areas except Barwon, East Gippsland and Central Gippsland will continue to have surplus beds based on the desired Commonwealth benchmark of 3.3 beds per 1 000 head of population.

Country hospital role conversion

3.8.208 In 1985, the Capital Works Review Committee recommended major changes to the role of some 39 country public hospitals due to:

- continuing low occupancy rates;
- high ratio of nursing home-type patients compared with acute patients;
- high average costs of patient treatment; and
- scope for the streamlining of hospital administration.

3.8.209 The Committee further recommended that the role changes for these hospitals be brought about by closing or merging hospitals, or converting them to nursing homes.

3.8.210 The 1986-87 Annual Report of the Health Department Victoria identified 9 more country hospitals as suitable for merger or role conversion and, in the 1991-92 health budget, a further 3 small rural hospitals were identified for role conversion.

3.8.211 The audit review found that, of the total 51 hospitals recommended for merger or role conversion, 73 per cent (37 hospitals) remained as stand-alone acute hospital facilities at June 1993.

3.8.212 Based on the on-going oversupply of acute beds in country Victoria, the Government should consider whether hospital mergers or conversions should proceed, particularly where public hospitals have continuing low occupancy rates, a high proportion of nursing home-type patients and alternate acute care facilities are available within reasonable proximity.

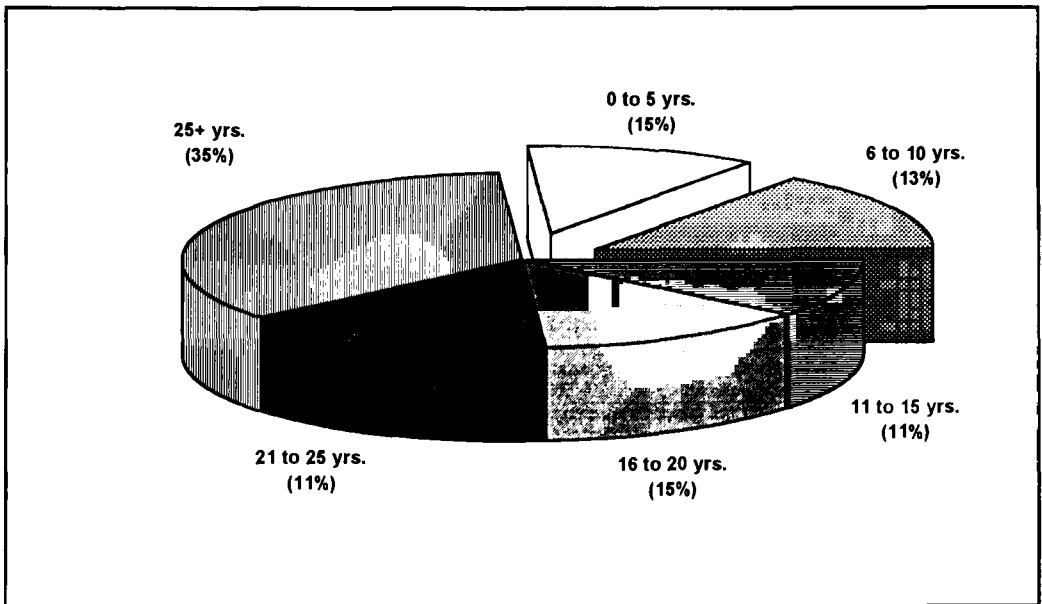
Condition of public hospital buildings

3.8.213 As part of the review, audit conducted a survey to establish the current condition of public hospitals within the State, with particular emphasis on:

- the age and condition of infrastructure at June 1993; and
- the extent of funding required to restore infrastructure to an acceptable level.

3.8.214 Chart 3.8M illustrates the estimated remaining useful life of major public hospital buildings, relating to the 92 hospitals which responded to this aspect of the survey.

CHART 3.8M
REMAINING USEFUL LIFE OF MAJOR PUBLIC HOSPITAL BUILDINGS



3.8.215 The survey revealed that 28 per cent of the public hospitals which responded to the survey indicated that their major buildings had a remaining useful life of less than 10 years.

3.8.216 In addition, an audit analysis of the survey responses indicated that:

- 41 hospitals maintained that some of their buildings were structurally unfit to function for their intended purpose;
- 6 hospitals indicated the need to remove asbestos, while 10 hospitals identified potential fire hazards;
- 65 hospitals considered that \$295 million was required to upgrade buildings currently in use to an acceptable standard. Of these hospitals, 21 are located in the Melbourne metropolitan area and would require upgrade works valued at \$117 million and the remaining 44 hospitals are located in country Victoria and require \$178 million of upgrade works;
- 26 of the 65 hospitals which saw a need to upgrade buildings to an acceptable standard had previously been identified for role conversion. The total cost of upgrade was estimated by these hospitals to be in excess of \$80 million; and
- 21 hospitals indicated that they did not have a preventative maintenance program.

3.8.217 Although audit did not verify the information provided by the various hospitals, the responses to the survey indicate that, *prima facie*, there is a major need to develop a long-term strategic approach to the management, including maintenance, of public hospital infrastructure. This is of particular importance, given the high level of under-utilisation and the current age profile of this important State resource.

□ RESPONSE provided by Secretary to the Department of Health and Community Services

I express my disappointment about the report on Acute Hospital Infrastructure. In essence it is irrelevant because of its failure to appreciate and incorporate the overwhelming contribution of casemix funding to the ongoing management of hospital infrastructure.

With the implementation of casemix funding in July 1993, the relationship between the Department and Public Hospitals has been fundamentally altered. The casemix system sets prices for different types of patient services which the Department purchases from hospitals, with the market being the ultimate arbiter of the type and volume of services provided.

The focus on output which is integral to casemix funding, creates powerful financial incentives for hospitals to maximise the use of all resources, including infrastructure, in producing patient services. Management in hospitals now have to take action to ensure that marginal costs are below or equal to marginal revenues. Hospitals can determine their own level of activity (and hence their level of use of the infrastructure available to them) within the variable budget parameters included in their Health Service Agreement, but it is critical that the relevant capital stock is intensively worked and recurrent costs minimised. In fact, increased utilisation has been occurring since the mid 1980s with patient throughput up 33 per cent, length of stay down 29 per cent and the introduction of new treatment practices and an expanded use of same day procedures. However, these trends are now reinforced as a direct result of the application of casemix.

Within this framework, the Department has been successful in gaining Treasury approval to alter the method of funding for capital projects and funding now tends to be provided at a strategy rather than project level. Capital funds are now provided in order to achieve ongoing financial viability for those hospitals where the present infrastructure is clearly a significant impediment to their financial performance. This recognises that much past planning of capital works has been restricted by the use of artificial bed to population ratios. Under the casemix environment the Department's position is to develop broad policy directions on the future shape of hospital services including the role of base and country hospitals. Additionally, some hospitals have been reluctant to divest themselves of excess assets e.g. nurses living accommodation after the transfer of nurse training to the tertiary colleges. The application of casemix funding will force these hospitals to take action to divest themselves of these surplus assets or to find alternate funding sources.

The report on Acute Hospital Infrastructure is stuck in a historical time-warp and limits scope to identifying so-called improvements in hospital infrastructure management against criticisms and deficiencies contained in 1983 and 1985 consultancy reports. While the Report therefore contains some interesting historical analysis, it provides no guidance to the Department Public Hospitals on the future vision for strategic capital planning and the management of hospital infrastructure.

Casemix, not bed to population ratios, is driving micro economic reform in Public Hospitals, on an unprecedented scale. The choice of an antiquated framework dooms this Report to irrelevance.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
MATTERS RESOLVED OR ACTION COMMENCED		
<i>Ministerial Portfolios, May 1993, p.157.</i>	Only 67 per cent of eligible school children participated in the 1991-92 Schools Dental Health Program, which was the lowest of all Australian States and Territories, except for New South Wales.	A survey was being undertaken to identify the reasons for the low rate of participation in the program in order to design and implement strategies to increase overall participation. The survey will also quantify the extent of duplication of private and public dental services.
<i>Ministerial Portfolios, May 1993, p.163.</i>	The failure of the Schools Dental Health Service to fully identify and treat children with high dental needs resulted in one of its major objectives not being achieved, thereby contributing to a lower dental health outcome for Victoria children.	The Service has released new guidelines for dental operators covering the treatment and follow-up of children with high dental needs. The Service was attempting to identify the causes for the non-completion of treatments provided to disadvantaged children in order to reduce these numbers.
<i>Ministerial Portfolios, May 1993, p.167.</i>	The Department should develop an overall strategic plan and establish appropriate performance indicators to enable management of the Kindergarten Program to be progressively measured.	A strategic plan was being developed for the Department's Primary Care Program which will incorporate objectives relevant for kindergartens. In addition, a project was commenced to develop appropriate performance indicators for the Kindergarten Program.
<i>Ministerial Portfolios, May 1993, pp. 168-9.</i>	An increase in the level of kindergarten teacher contact hours and revised work arrangements would enhance opportunities for improving the efficiency of kindergarten services in Victoria and could lead to substantial savings in government subsidies.	Employment agreements have been finalised with many staff which provide for increased teacher contact hours and more flexible working arrangements. In addition, 75 per cent of kindergartens are providing an expanded number of services in 1994.
<i>Ministerial Portfolios, May 1993, pp. 171-2.</i>	There is scope for improvement in the curriculum development assistance provided by the Department to kindergarten management.	A working party was formed by the Department with responsibility for assessing curriculum development. Research was being undertaken to identify strategies that Committees of Management may implement to improve curriculum development and assessment.
<i>Ministerial Portfolios, May 1993, p. 174.</i>	The Government could be exposed to a risk of unlimited liability in respect of 5 unregistered kindergarten centres.	The Department has advised all kindergartens that funding will be withheld if registration is not current.
<i>Ministerial Portfolios, May 1993, p. 175.</i>	There was an absence of accountability arrangements for kindergartens operated by municipal councils.	All municipal councils have entered into funding and service agreements with the Department.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
NO ACTION TAKEN		
<i>Ministerial Portfolios, May 1993, p.153.</i>	Due to the failure of the Schools Dental Health Service and the Department to adequately examine alternate service delivery methods, such as outsourcing, taxpayers could not be assured that the current Schools Dental Health Program was provided in the most cost-efficient manner.	While the Service has taken action to review the cost-efficiency of the current form of service delivery, there has been no examination of alternate service delivery methods.
<i>Ministerial Portfolios, May 1993, p.154.</i>	The coverage of dental services provided to Victorian school children is limited in comparison to services provided in other States.	Due to budget constraints, services have not been extended to equate with other States.

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Department of Health and Community Services	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	27 Oct. 1993	29 Oct. 1993
HEALTH				
Ambulance Officers' Training Centre	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8.</i>	9 Sept. 1993	24 Sept. 1993
Alexandra and District Ambulance Service	30 June 1993	No reporting requirements. <i>Ambulance Services Act 1986, s.38</i> provides for the audit of the accounts.	24 Aug. 1993	11 Oct. 1993
Ambulance Service Victoria -				
Metropolitan Region	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8.</i>	21 Sept. 1993	27 Sept. 1993
North Eastern Region	30 June 1993	" "	17 Aug. 1993	24 Sept. 1993 (a)
North Western Region	30 June 1993	" "	16 Aug. 1993	24 Sept. 1993 (a)
South Eastern Region	30 June 1993	" "	6 Aug. 1993	24 Sept. 1993 (a)
South Western Region	30 June 1993	" "	9 Aug. 1993	24 Sept. 1993 (a)
Western Region	30 June 1993	" "	12 Aug. 1993	17 Sept. 1993 (a)
Mental Health Review Board	30 June 1993	30 Sept. <i>Mental Health Act 1986, s.136.</i>	30 Sept. 1993	30 Sept. 1993
Optometrists Registration Board	30 June 1993	30 Sept. <i>Optometrists Registration Act 1958, s.22.</i>	1 Nov. 1993	26 Nov. 1993
Physiotherapists Registration Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8.</i>	12 Oct. 1993	29 Oct. 1993
Prince Henry's Institute of Medical Research	31 Dec. 1993	31 Mar. <i>Annual Reporting Act 1983, s.8.</i>	28 Mar. 1994	30 Mar. 1994
Psychosurgery Review Board	30 June 1993	30 Sept. <i>Mental Health Act 1986, s.138.</i>	30 Sept. 1993	30 Sept. 1993
Royal District Nursing Service	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8.</i>	17 Feb. 1994	21 Feb. 1994
Victorian Health Promotion Foundation	30 June 1993	" "	7 Sept. 1993	8 Sept. 1993
Victorian Nursing Council	30 June 1993	31 Oct. <i>Nurses Act 1958, s.40.</i>	22 Sept. 1993	30 Sept. 1993

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
VICTORIAN PUBLIC HOSPITALS AND NURSING HOMES				
Alexandra District Hospital	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8. Extension granted to 31 Oct.</i>	16 Sept. 1993	21 Oct. 1993
Alfred Group of Hospitals	30 June 1993	" "	2 Sept. 1993	7 Oct. 1993 (a)
Altona District Hospital	30 June 1993	" "	22 Sept. 1993	13 Oct. 1993
Angliss Hospital	30 June 1993	" "	16 Sept. 1993	6 Oct. 1993
Anne Caudle Centre	30 June 1993	" "	17 Sept. 1993	22 Oct. 1993 (a)
Apollo Bay & District Memorial Hospital	30 June 1993	" "	10 Sept. 1993	18 Oct. 1993 (a)
Ararat & District Hospital	30 June 1993	" "	24 Aug. 1993	8 Oct. 1993 (a)
Austin Hospital	30 June 1993	" "	13 Sept. 1993	7 Oct. 1993 (a)
Bacchus Marsh & Melton Memorial Hospital	30 June 1993	" "	17 Sept. 1993	20 Oct. 1993 (a)
Bairnsdale Regional Health Service	30 June 1993	" "	13 Sept. 1993	13 Oct. 1993 (a)
Ballarat Base Hospital	30 June 1993	" "	23 Sept. 1993	28 Oct. 1993
Beeac & District Hospital	30 June 1993	" "	21 Sept. 1993	11 Oct. 1993 (a)
Beechworth Hospital	30 June 1993	" "	14 Jan. 1994	16 Feb. 1994 (a)
Benalla & District Memorial Hospital	30 June 1993	" "	7 Oct. 1993	11 Oct. 1993 (a)
Bendigo Hospital	30 June 1993	" "	28 Oct. 1993	17 Nov. 1993 (a)
Bethlehem Hospital Incorporated	30 June 1993	" "	11 Sept. 1993	20 Oct. 1993
Birregurra & District Community Hospital	30 June 1993	" "	16 Sept. 1993	20 Oct. 1993 (a)
Boort District Hospital	30 June 1993	" "	10 Sept. 1993	18 Oct. 1993 (a)
Box Hill Hospital	30 June 1993	" "	1 Sept. 1993	16 Sept. 1993
Bright District Hospital	30 June 1993	" "	7 Oct. 1993	27 Oct. 1993

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - <i>continued</i>				
Bundoora Extended Care Centre	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8. Extension granted to 31 Oct.</i>	10 Sept. 1993	25 Oct. 1993 (a)
Burwood & District Community Hospital	30 June 1993	" "	10 Sept. 1993	20 Oct. 1993
Camperdown District Hospital	30 June 1993	" "	7 Sept. 1993	25 Oct. 1993 (a)
Caritas Christi Hospice Limited	30 June 1993	" "	15 Sept. 1993	8 Oct. 1993
Casterton Memorial Hospital	30 June 1993	" "	25 Aug. 1993	19 Oct. 1993 (a)
Clunes District Hospital	30 June 1993	" "	21 Sept. 1993	21 Oct. 1993
Cobram District Hospital	30 June 1993	" "	5 Aug. 1993	23 Aug. 1993 (a)
Cohuna District Hospital	30 June 1993	" "	10 Sept. 1993	19 Oct. 1993 (a)
Colac District Hospital	30 June 1993	" "	16 Sept. 1993	8 Oct. 1993 (a)
Coleraine & District Hospital	30 June 1993	" "	19 Oct. 1993	28 Oct. 1993 (a)
Corryong District Hospital	30 June 1993	" "	30 Sept. 1993	23 Oct. 1993 (a)
Creswick District Hospital	30 June 1993	" "	14 Sept. 1993	27 Oct. 1993
Dandenong Hospital	30 June 1993	" "	6 Sept. 1993	18 Oct. 1993
Daylesford District Hospital	30 June 1993	" "	28 Sept. 1993	29 Oct. 1993 (a)
Dimboola District Hospital	30 June 1993	" "	11 Aug. 1993	13 Oct. 1993 (a)
Donald District Hospital	30 June 1993	" "	18 Oct. 1993	26 Oct. 1993 (a)
Dunmunkle Health Services	30 June 1993	" "	21 Oct. 1993	28 Oct. 1993 (a)
Dunolly District Hospital	30 June 1993	" "	17 Sept. 1993	8 Oct. 1993 (a)
Eastern Suburbs Geriatric Centre	30 June 1993	" "	9 Sept. 1993	14 Oct. 1993 (a)
Echuca District Hospital Incorporated	30 June 1993	" "	24 Sept. 1993	29 Oct. 1993 (a)

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
Edenhope & District Memorial Hospital	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8. Extension granted to 31 Oct.</i>	10 Sept. 1993	18 Oct. 1993 (a)
Eildon & District Community Hospital	30 June 1993	" "	30 Sept. 1993	25 Oct. 1993
Elmore District Hospital	30 June 1993	" "	24 Sept. 1993	20 Oct. 1993 (a)
Fairfield Hospital	30 June 1993	" "	8 Oct. 1993	27 Oct. 1993 (a)
Geelong Hospital	30 June 1993	" "	27 Aug. 1993	15 Sept. 1993
Gippsland Base Hospital	30 June 1993	" "	31 Aug. 1993	27 Sept. 1993 (a)
Gippsland Southern Health Service	30 June 1993	" "	30 Sept. 1993	29 Oct. 1993 (a)
Glenview Community Care Inc.	30 June 1993	" "	8 Sept. 1993	13 Oct. 1993 (a)
Goulburn Valley Base Hospital	30 June 1993	" "	8 Sept. 1993	18 Oct. 1993 (a)
Grace McKellar Centre	30 June 1993	" "	10 Sept. 1993	21 Oct. 1993 (a)
Hamilton Base Hospital	30 June 1993	" "	1 Sept. 1993	21 Oct. 1993
Hampton Rehabilitation Hospital	30 June 1993	" "	21 Sept. 1993	29 Oct. 1993 (a)
Healesville & District Hospital	30 June 1993	" "	10 Sept. 1993	14 Oct. 1993 (a)
Heathcote District Hospital	30 June 1993	" "	24 Sept. 1993	19 Oct. 1993 (a)
Heywood & District Memorial Hospital	30 June 1993	" "	30 Sept. 1993	27 Oct. 1993 (a)
Inglewood Hospital	30 June 1993	" "	17 Sept. 1993	19 Oct. 1993 (a)
Kaniva District Hospital	30 June 1993	" "	14 Sept. 1993	18 Oct. 1993 (a)
Kerang & District Hospital	30 June 1993	" "	9 Sept. 1993	20 Oct. 1993 (a)
Kilmore & District Hospital	30 June 1993	" "	9 Sept. 1993	13 Oct. 1993 (a)
Kingston Centre	30 June 1993	" "	27 Sept. 1993	26 Oct. 1993 (a)

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
Koroit & District Memorial Hospital	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8. Extension granted to 31 Oct.</i>	8 Sept. 1993	21 Sept. 1993 (a)
Korumburra District Hospital	18 Aug. 1992	" "	29 Sept. 1993	29 Oct. 1993 (a)
Kyabram & District Memorial Community Hospital	30 June 1993	" "	7 Sept. 1993	22 Sept. 1993 (a)
Kyneton District Hospital	30 June 1993	" "	10 Sept. 1993	13 Oct. 1993
Latrobe Regional Hospital	30 June 1993	" "	16 Sept. 1993	18 Oct. 1993 (a)
Lismore & District Hospital	30 June 1993	" "	1 Oct. 1993	29 Oct. 1993
Lorne Community Hospital	30 June 1993	" "	13 Sept. 1993	8 Oct. 1993 (a)
Lyndoch Warrnambool	30 June 1993	" "	10 Sept. 1993	18 Oct. 1993 (a)
Macarthur & District Memorial Hospital	30 June 1993	" "	8 Sept. 1993	19 Oct. 1993 (a)
Maffra District Hospital	30 June 1993	" "	21 Sept. 1993	23 Oct. 1993
Maldon Hospital	30 June 1993	" "	24 Sept. 1993	23 Oct. 1993 (a)
Manangatang & District Hospital	30 June 1993	" "	24 Sept. 1993	28 Oct. 1993 (a)
Mansfield District Hospital	30 June 1993	" "	28 Sept. 1993	26 Oct. 1993
Maroondah Hospital	30 June 1993	" "	15 Sept. 1993	8 Oct. 1993 (a)
Maryborough & District Hospital	30 June 1993	" "	25 Aug. 1993	20 Sept. 1993 (a)
Mercy Public Hospital Inc.	30 June 1993	" "	27 Sept. 1993	26 Oct. 1993
Mildura Base Hospital	30 June 1993	" "	10 Sept. 1993	27 Oct. 1993 (a)
Monash Medical Centre	30 June 1993	" "	10 Sept. 1993	14 Oct. 1993
Mordialloc-Cheltenham Community Hospital	30 June 1993	" "	17 Sept. 1993	23 Oct. 1993 (a)
Mornington Peninsula Hospital	30 June 1993	" "	10 Sept. 1993	30 Sept. 1993 (a)

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
Mortlake District Hospital	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8. Extension granted to 31 Oct.</i>	16 Sept. 1993	18 Oct. 1993 (a)
Mount Eliza Centre	30 June 1993	" "	10 Sept. 1993	13 Oct. 1993 (a)
Mt Alexander Hospital	30 June 1993	" "	3 Sept. 1993	20 Sept. 1993 (a)
Myrtleford District War Memorial Hospital	30 June 1993	" "	10 Sept. 1993	18 Oct. 1993 (a)
Nathalia District Hospital	30 June 1993	" "	8 Sept. 1993	24 Sept. 1993 (a)
Nhill Hospital	30 June 1993	" "	15 Sept. 1993	29 Oct. 1993
North West Hospital	30 June 1993	" "	23 Sept. 1993	21 Oct. 1993
Numurkah & District War Memorial Hospital	30 June 1993	" "	1 Sept. 1993	28 Sept. 1993
Omeo District Hospital	30 June 1993	" "	4 Oct. 1993	13 Oct. 1993 (a)
Orbost & District Hospital	30 June 1993	" "	28 Sept. 1993	21 Oct. 1993 (a)
Ouyen & District Hospital	30 June 1993	" "	28 Sept. 1993	29 Oct. 1993 (a)
Ovens District Hospital	17 Aug. 1992	" "	14 Jan. 1994	16 Feb. 1994
Ovens & Murray Hospital For The Aged	17 Aug. 1992	" "	14 Jan. 1994	16 Feb. 1994 (a)
O'Connell Family Centre (Grey Sisters) Inc.	30 June 1993	" "	13 Aug. 1993	6 Oct. 1993
Penshurst & District Memorial Hospital	30 June 1993	" "	3 Sept. 1993	19 Oct. 1993 (a)
Peter Maccallum Cancer Institute	30 June 1993	" "	8 Sept. 1993	14 Oct. 1993 (a)
Port Fairy Hospital	30 June 1993	" "	10 Sept. 1993	8 Oct. 1993 (a)
Portland & District Hospital	30 June 1993	" "	23 Aug. 1993	7 Oct. 1993 (a)
Preston & Northcote Community Hospital	30 June 1993	" "	10 Sept. 1993	28 Oct. 1993 (a)
Queen Elizabeth Centre	30 June 1993	" "	6 Sept. 1993	14 Oct. 1993 (a)

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
Queen Elizabeth Centre Ballarat	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8. Extension granted to 31 Oct.</i>	22 Sept. 1993	19 Oct. 1993
Ripon Peace Memorial Hospital	30 June 1993	" "	1 Oct. 1993	29 Oct. 1993 (a)
Rochester & District War Memorial Hospital	30 June 1993	" "	18 Oct. 1993	19 Oct. 1993 (a)
Royal Children's Hospital	30 June 1993	" "	10 Sept. 1993	7 Oct. 1993
Royal Dental Hospital Of Melbourne	30 June 1993	" "	10 Sept. 1993	29 Oct. 1993 (a)
Royal Melbourne Hospital	30 June 1993	" "	13 Sept. 1993	18 Oct. 1993 (a)
Royal Victorian Eye & Ear Hospital	30 June 1993	" "	7 Sept. 1993	30 Sept. 1993
Royal Women's Hospital	30 June 1993	" "	9 Sept. 1993	14 Oct. 1993 (a)
Sandringham & District Memorial Hospital	30 June 1993	" "	20 Sept. 1993	24 Sept. 1993 (a)
Seymour District Memorial Hospital	30 June 1993	" "	1 Oct. 1993	26 Oct. 1993
Skipton & District Memorial Hospital	30 June 1993	" "	13 Oct. 1993	27 Oct. 1993 (a)
South Gippsland Hospital	30 June 1993	" "	1 Sept. 1993	6 Oct. 1993
St. Arnaud District Hospital	30 June 1993	" "	8 Sept. 1993	8 Oct. 1993 (a)
St George's Hospital & Inner Eastern Geriat. Service	30 June 1993	" "	17 Sept. 1993	18 Oct. 1993 (a)
St Vincent's Hospital (Melbourne) Limited	30 June 1993	" "	10 Sept. 1993	11 Oct. 1993 (a)
Stawell District Hospital	30 June 1993	" "	13 Sept. 1993	8 Oct. 1993 (a)
Swan Hill District Hospital	30 June 1993	" "	6 Sept. 1993	18 Oct. 1993 (a)
Tallangatta Hospital	30 June 1993	" "	10 Sept. 1993	13 Oct. 1993 (a)
Tawonga District General Hospital	30 June 1993	" "	1 Oct. 1993	28 Oct. 1993 (a)
Terang & District (Norah Cosgrave) Community Hospital	30 June 1993	" "	9 Sept. 1993	22 Sept. 1993 (a)

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>		<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued					
Timboon & District Hospital	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8. Extension granted to 31 Oct.</i>		16 Sept. 1993	18 Oct. 1993 (a)
Tweddle Chid & Family Health Service	30 June 1993	"	"	24 Aug. 1993	13 Oct. 1993
Wangaratta District Base Hospital	30 June 1993	"	"	8 Sept. 1993	20 Oct. 1993 (a)
Waranga Memorial Hospital	30 June 1993	"	"	3 Sept. 1993	1 Oct. 1993 (a)
Warracknabeal District Hospital	30 June 1993	"	"	20 Sept. 1993	29 Oct. 1993 (a)
Warnambool & District Base Hospital	30 June 1993	"	"	15 Sept. 1993	19 Oct. 1993 (a)
Werribee District Hospital	30 June 1993	"	"	10 Sept. 1993	18 Oct. 1993
West Gippsland Hospital	30 June 1993	"	"	18 Oct. 1993	29 Oct. 1993
Western Hospital	30 June 1993	"	"	13 Sept. 1993	20 Oct. 1993 (a)
Westernport Memorial Hospital	30 June 1993	"	"	6 Oct. 1993	29 Oct. 1993 (a)
Willaura & District Hospital	30 June 1993	"	"	26 Aug. 1993	8 Oct. 1993 (a)
Williamstown Hospital	30 June 1993	"	"	6 Sept. 1993	1 Oct. 1993 (a)
Wimmera Base Hospital	30 June 1993	"	"	14 Sept. 1993	22 Oct. 1993 (a)
Winchelsea & District Hospital	30 June 1993	"	"	21 Sept. 1993	8 Oct. 1993 (a)
Wodonga District Hospital	30 June 1993	"	"	10 Sept. 1993	13 Oct. 1993 (a)
Wonthaggi and District Hospital	30 June 1993	"	"	23 Sept. 1993	27 Oct. 1993
Woorayl District Memorial Hospital	18 Aug. 1992	"	"	24 Sept. 1993	29 Oct. 1993 (a)
Wycheproof District Hospital	30 June 1993	"	"	13 Sept. 1993	8 Oct. 1993 (a)

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS - continued				
Yarram & District Health Service	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.8. Extension granted to 31 Oct.</i>	10 Sept. 1993	13 Oct. 1993
Yarrawonga District Hospital	30 June 1993	" "	30 Sept. 1993	23 Oct. 1993 (a)
Yea & District Memorial Hospital	30 June 1993	" "	7 Sept. 1993	11 Oct. 1993 (a)

(a) Qualified audit report issued.

Part 3.9

Justice

KEY FINDINGS

DEPARTMENT OF JUSTICE

Enforcement of fines - motor vehicle related offences

- Uncollected fines increased from \$41.3 million at 30 June 1987 to \$131.7 million at 30 June 1993. This represents the accumulated amount owed by 7 per cent of offenders who fail to pay their fines.
Paras 3.9.8 to 3.9.9 and 3.9.23
- The number of unexecuted warrants increased from 866 000 at 30 June 1992 to 1.1 million at 30 June 1993 which relate to 108 000 individuals and entities.
Paras 3.9.26 to 3.9.27
- In addition to the \$131.7 million due to the State, an amount of \$61.2 million is outstanding in respect of infringement notices issued by local government.
Para. 3.9.30
- Unless the Sheriff is provided with increased enforcement options for the execution of warrants, the level of uncollected fines will continue to grow.
Paras 3.9.35 to 3.9.37
- The enforcement option of suspension of driver licence is not totally effective in obtaining payment of uncollected fines as only 57 per cent of offenders threatened with suspension of driver licence paid the fine.
Para. 3.9.39
- Location of offenders is an ongoing problem with 58 per cent of all warrants being returned unexecuted due to the absence of a reliable database to identify the whereabouts of offenders.
Paras 3.9.45 to 3.9.47
- The excessive timelag of 119 days between the date the offence is committed and the date a warrant is issued to the Sheriff by the PERIN Court, has contributed to difficulties in locating offenders.
Paras 3.9.49 to 3.9.51
- Statistics maintained on productivity indicate that the Sheriff has achieved productivity gains as a result of development of innovative warrant execution techniques.
Paras 3.9.52 to 3.9.53

3.9.1 Five Ministers, namely the Attorney-General, the Minister for Corrections, the Minister for Fair Trading, the Minister for Police and Emergency Services and the Minister for Women's Affairs, have responsibility for operations within the Justice sector. These Ministers have collective responsibility for the Department of Justice.

3.9.2 Details of the specific ministerial responsibilities for public bodies within the Justice sector are listed in Table 3.9A. These public bodies, together with the Department of Justice, are subject to audit by the Auditor-General.

TABLE 3.9A
MINISTERIAL RESPONSIBILITIES WITHIN THE FINANCE SECTOR

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Attorney-General	Estate Agents Board Guardianship and Administration Board Legal Aid Commission of Victoria Legal Aid Commission Staff Superannuation Fund Office of the Director of Public Prosecutions Office of the Public Advocate Patriotic Funds Council of Victoria State Electoral Office State Trust Corporation of Victoria Victorian Financial Institutions Commission Victorian Institute of Forensic Pathology
Corrections (a)	Victorian Prison Industries Commission
Fair Trading (a)(b)	-
Police and Emergency Services	Country Fire Authority Metropolitan Fire Brigades Board National Institute of Forensic Science National Police Ethnic Advisory Bureau Office of the Chief Commissioner of Police
Women's Affairs (a)	-

(a) Minister has responsibility for certain functions of the Department of Justice.

(b) Includes responsibility for Residential Tenancy Fund.

3.9.3 Comment on matters of significance arising from the audit of the Department of Justice is provided below.

DEPARTMENT OF JUSTICE

ENFORCEMENT OF FINES - MOTOR VEHICLE RELATED OFFENCES

Background

3.9.4 The overall objective of the Department of Justice is to ensure the efficient operation and development of the legal system including the fine enforcement function.

3.9.5 In the *Second Report of the Auditor-General for the year 1986-87*, audit concluded that the shared responsibility between the Office of the Chief Commissioner of Police and the Courts for the control and follow-up of uncollected fines, had adversely impacted on State revenue collections. At 30 June 1987, uncollected fines totalled \$41.3 million.

3.9.6 The Department at that time advised that it had long recognised more efficient and effective systems of control were required and that it proposed to transfer the responsibility for the fine enforcement function from the Police to the Sheriff's Office. The Sheriff is an officer of the Supreme Court and is responsible for the enforcement of warrants issued by the Supreme, County and Magistrates' Courts.

3.9.7 In 1988 a submission to Cabinet proposed the transfer of responsibility for the collection of fines from the Police to the Sheriff's Office and the provision of a range of measures which offered greater enforcement options. The *Magistrates' (Summary Proceedings) (Sheriff) Act 1989*, which was proclaimed in April 1989, allowed the Sheriff to take over the enforcement of fines relating to warrants issued after 4 April 1989. In the *Auditor-General's Reports on Ministerial Portfolios* in 1989, 1990 and 1991, critical comment was made of the continuing ineffectiveness of the enforcement processes for warrants over which the Police still had control. Warrants issued before 4 April 1989 for execution by the Police, were progressively re-issued by the Courts for execution by the Sheriff and this process was completed during 1991-92.

3.9.8 Statistics maintained by the Department indicated that 90 per cent of offenders who were fined for an offence arising out of the use of a motor vehicle in Victoria, such as parking offences or traffic infringements, settled their fines within the stipulated periods allowed before State or local government agencies referred the matter to a court for issue of a court order. A further 1.5 per cent then paid within the period allowed by the court order before issue of a warrant. Of the remainder, 1.5 per cent subsequently settle the fine by way of either payment, imprisonment or a community based order, **while 7 per cent of offenders fail to pay**. The uncollected fines owing by these offenders is quite substantial and is growing each year.

3.9.9 While it is accepted that offenders may choose methods other than cash payment to meet penalties imposed, the amount potentially due to the State totals \$208.9 million, comprising \$131.7 million in uncollected fines and \$77.2 million in execution costs.

3.9.10 Audit undertook a review of the Sheriff's Office in 1993 to determine why there has been a growth in the number of outstanding warrants and what action, if any, has been implemented to improve the execution rate and, consequently, the collection of fines.

OVERALL CONCLUSION

3.9.11 Since 1986-87 audit has been critical of the uncollected fines owed to the State during which time the debt has grown from \$41.3 million to \$131.7 million. Audit concluded that there were several factors which had contributed to the substantial increase in the amount of uncollected fines viz:

- inadequacies in the enforcement options available to the Sheriff's Office limits its effectiveness;
- lack of reliability of the database used by the Sheriff to identify the whereabouts of offenders; and
- the excessive timelag of 119 days between the date the offence is committed and the date a warrant is available for execution contributes to the difficulties in locating offenders.

3.9.12 Until such time as the Government overcomes the constraints faced by the Sheriff in the execution of warrants, the State will continue to accumulate substantial uncollected fines.

OVERALL CONCLUSION - continued

3.9.13 Audit is of the view that the failure to adopt the enforcement package originally proposed, particularly the powers of seizure of personal property and the suspension of motor vehicle registration, has contributed to the continued increase in the volume of unexecuted warrants held by the Sheriff.

3.9.14 The Sheriff, operating within the constraints of the current fine enforcement system, has had to continuously review and develop innovative warrant execution techniques. While audit notes recent public statements by the Attorney-General and the Sheriff of the intention to introduce legislation for the seizure of personal property, the difficulty experienced by the Sheriff in locating offenders still remains unresolved.

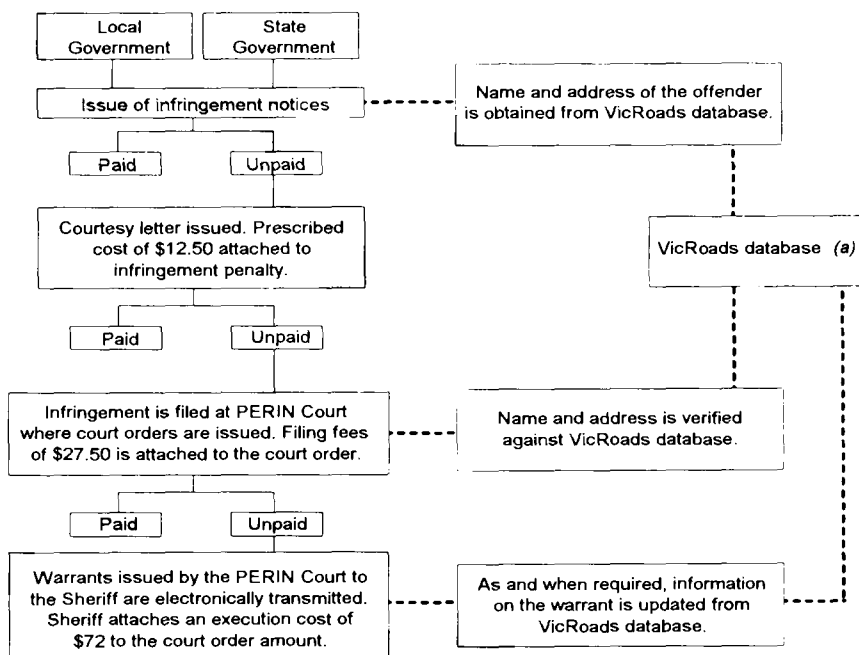
□ RESPONSE provided by Director, Courts and Tribunal Services

The issues raised in the Report concerning the level of uncollected fines and the measures needed to substantially improve the situation have been recognised by the Department. The Report does describe the measures the Department has taken to date. The Government recognises the importance of the issues, and the matter is being dealt with as a matter of priority through a number of additional initiatives now in the process of implementation.

Enforcement system

3.9.15 Before discussing the findings of the review, it is appropriate to describe how the fine enforcement system operates. In this Report, the term fine includes the initial fine as well as the prescribed fees which attach to the warrant at various stages of the enforcement process. The details set out in Chart 3.9B relates to the enforcement system for motor vehicle offences, as they constitute the majority of offences for which fines are imposed.

**CHART 3.9B
THE ENFORCEMENT SYSTEM**



(a) Roads Corporation of Victoria (VicRoads).

Infringement notices

3.9.16 While certain agencies have legislative authority to impose automatic fines for motor vehicle related offences, the main State Government agency issuing fines is the Police. Offences detected through the use of speed detection devices, such as speed cameras, are handled through the Police Traffic Camera Office (TCO), while other offences are handled through the Police Fixed Penalty Payment Office (FPPO). The TCO and the FPPO issue Traffic Infringement Notices (TINs) and Penalty Infringement Notices (PINs), respectively, under the *Road Safety Act 1986*. The amount of the fine applicable to each offence is determined by the Road Safety (Procedure) Regulations 1988. PINs are issued at the time the offence is detected and are commonly referred to as *on-the-spot fines*. TINs, on the other hand, are issued following the processing of film from the photographic detection device. Local government agencies, such as municipal councils, are authorised by the *Road Safety Act 1986* to impose fines for offences such as parking infringements.

3.9.17 For motor vehicle related offences, the principle of *owner omnis* applies, i.e. **the registered owner of the vehicle at the time the offence is committed is liable to meet any penalty imposed.** The agencies utilise the VicRoads vehicle registration and driver licence databases to obtain the name and address of the registered owner of the motor vehicle to which the offence relates.

Courtesy letters

3.9.18 The *Magistrates' Court Act 1989* states that a courtesy letter may be issued where payment of a penalty is not received before the expiration of the specified time. The courtesy letter, which is issued by the agency imposing the fine, requests payment of the penalty together with a prescribed cost currently set by the Magistrates' Court Regulations 1993 at \$12.50.

Court orders

3.9.19 Should a penalty remain uncollected on expiry of the allowed period after issue of a courtesy letter, the agencies may file the penalty at the *Penalty Enforcement by Registration of Infringement Notice (PERIN) Court* for registration and issue of a court order to the offender. The PERIN Court was established in 1986 to deal with uncontested prosecutions for relatively minor traffic offences.

3.9.20 Table 3.9C details the composition of penalties filed at the PERIN Court.

TABLE 3.9C
FINES FILED AT PERIN COURT

	<i>Per cent</i>
State government agencies -	
Police -	
Traffic Camera Office	25
Fixed Penalty Payments Office	15
Other budget sector agencies	5
Local government agencies	55
Total	100

Source: Information provided by Registrar of the PERIN Court.

3.9.21 Should payment of the court order not be made within the period of 42 days, or an offender defaults on a payment by instalment arrangement entered into with the Court, a warrant is issued to the Sheriff for enforcement.

Sheriff's warrant

3.9.22 The Sheriff issues a notice informing the offender of the intention to execute the warrant if payment is not made within 7 days. At the expiry of this period, the Sheriff returns to either collect the amount of the warrant or negotiate an instalment payment arrangement, or issue a Notice of Intended Suspension of Driver Licence under the *Road Safety Act 1986* or imprison the offender.

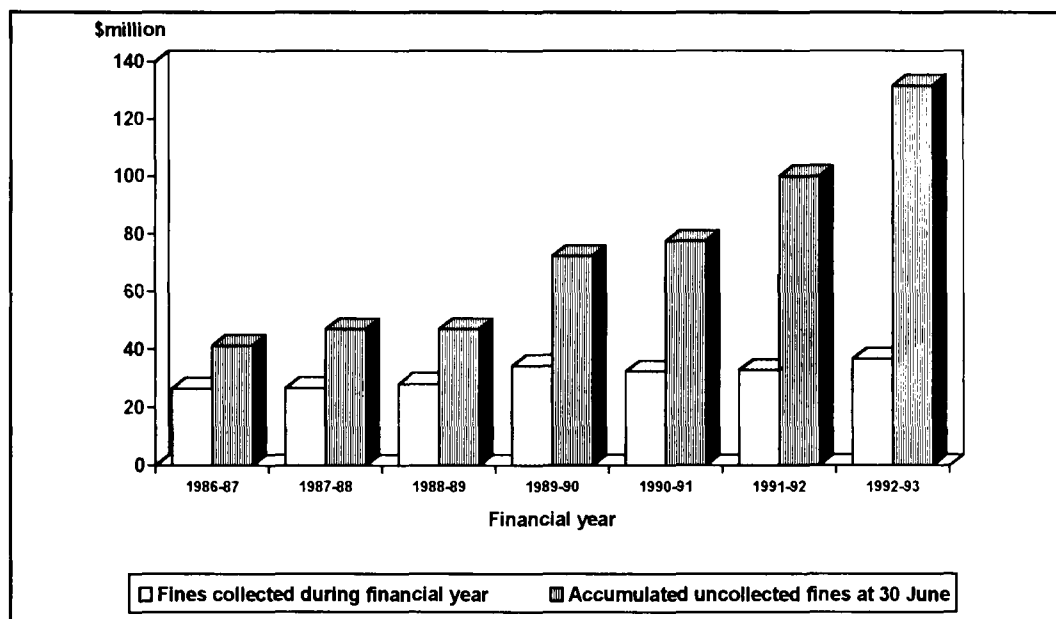
Growth and current status of uncollected fines

Growth

3.9.23 When audit first raised the issue of uncollected fines in 1986-87 the value of those fines, **excluding fines payable to local government agencies**, was \$41.3 million. At 30 June 1993, the amount of uncollected fines due to the State was \$131.7 million. In addition, there was \$77.2 million attached to warrants for the recovery of execution costs. These costs are payable only upon execution of warrants for the cash penalty. Where a warrant is returned to Court for an arrangement for payment of a fine by instalments, the **execution cost is not payable, irrespective of the costs incurred by the Sheriff in locating the offender**. This situation arises because the Magistrates' Court (Fees, Costs and Charges) (Amendment) Regulations 1993, which sets the quantum of the execution cost, provides that the amount is **payable only** to the Sheriff.

3.9.24 Chart 3.9D compares the growth in uncollected fines at 30 June over a 7 year period to 30 June 1993, with fines collected during those financial years as disclosed in the Department's Annual Reports.

CHART 3.9D
GROWTH IN FINES, 1986-87 TO 1992-93



3.9.25 During the 2 year period to June 1989, uncollected court fines increased by 13 per cent to \$46.9 million. One year later, outstanding fines had increased to \$72.6 million. Due to the absence of statistical data before 1990-91 relating to the number of warrants issued to the Sheriff, audit has been unable to analyse the factors contributing to the increase in outstanding fines during this 3 year period. However, the increase in the number of prosecuted offences from 90 to 600 with the establishment of the PERIN Court and the introduction of speed detection devices are the most likely contributing factors.

3.9.26 According to records maintained by the Sheriff, the number of unexecuted warrants increased from 866 150 at 30 June 1992 to 1 108 041 at 30 June 1993. The unexecuted warrants at 30 June 1993 relate to 107 879 individuals and entities.

3.9.27 Review of uncollected fines at the date of this Report indicated that there were 38 individuals and 16 corporations who each had a minimum of 100 outstanding warrants. **In one instance an individual had committed 329 offences in the one motor vehicle during the period 1989 to 1992.**

3.9.28 The fact that this minority is able to continue to offend, apparently with impunity, effectively undermines the authority of the legal system. The cost of executing warrants in these cases also places a further financial burden on the other members of the community.

3.9.29 By way of comparison with the amount of uncollected fines, the State has budgeted to raise \$170 million from the State Deficit Levy in 1993-94. The decision to impose this levy on all Victorian householders may not have been necessary if this small minority had met their obligations.

Current status

3.9.30 Table 3.9E details the total uncollected fines and execution costs at 30 June 1993.

TABLE 3.9E
UNCOLLECTED FINES AS AT 30 JUNE 1993
(\$million)

<i>Description</i>	<i>Payable to the State</i>	<i>Payable to local government</i>	<i>Total</i>
Courts - court orders	25.7	(a)	25.7
Sheriff - warrants	106.0	61.2	167.2
Uncollected fines	131.7	61.2	192.9
Execution costs (b)	77.2		77.2
Total	208.9	61.2	270.1

(a) This information is not available in the *Annual Report* of the Department of Justice.

(b) Execution costs are attached to all warrants executed by the Sheriff.

3.9.31 Audit recognises that the amount of outstanding fines will not all be collected as a result of the non-monetary options available to offenders, such as imprisonment, suspension of driver licence or community-based orders, to satisfy outstanding fines and the lapsing of warrants. In this latter context, the *Magistrates' Court Act 1989*, provides that "... a warrant to imprison for non-payment of a fine, irrespective of whether it was issued before or subsequent to the proclamation of the Act, was null and void if it had not been executed within 5 years after issue". This legislation effectively removed the requirement for offenders to pay fines outstanding in excess of 5 years.

3.9.32 To 30 June 1993, warrants with a face value of \$7.7 million including fines and associated costs which represent fines issued prior to 1988, had lapsed. The Act, however, provides that "... with the leave of a Court a fresh warrant may be issued for the same purpose as that for which a warrant had become null and void".

Concurrency

3.9.33 Prior to the proclamation of the *Sentencing Act 1991* on 25 June 1991, offenders were allowed to satisfy multiple outstanding warrants by serving the imprisonment penalty under one warrant, i.e. concurrently. The Act altered the concurrency provisions applicable to imprisonment terms imposed in default of payment of a fine. In respect of warrants issued after the proclamation date of the Act, offenders are required to serve the imprisonment penalty on each warrant. As the legislation was not retrospective, warrants issued prior to 25 June 1991 remain subject to the concurrency provisions of the *Penalties and Sentences Act 1985*.

Why is the enforcement system ineffective?

3.9.34 The review identified a number of issues which, in audit opinion, have contributed to the current ineffectiveness of the enforcement system for outstanding warrants. These issues are discussed in the following paragraphs.

Sheriff's inadequate enforcement options

3.9.35 The transfer of the enforcement function from the Police to the Sheriff necessitated a major expansion of the operations of the Sheriff, both in terms of personnel and computer resources. In order to meet the additional responsibilities, there was a commensurate increase in the number of personnel employed from 118 to a peak of 319.

3.9.36 At the time of the transfer, the Department saw a key element to ensure the effective enforcement of outstanding warrants as being an increase in the powers of the Sheriff through the provision of a greater range of enforcement options. However, only limited enforcement options were provided to the Sheriff, as summarised in Table 3.9F below.

TABLE 3.9F
SHERIFF'S ENFORCEMENT OPTIONS

<i>Enforcement options proposed</i>	<i>Actual options provided</i>
Imprisonment	Yes
Suspend driver licences - individuals	Yes, vehicle related offences only
Suspend motor vehicle registration - Individuals	No
Corporate bodies (all vehicles registered in the name of the corporate body)	Yes, but offending vehicle only
Seizure of personal property	Yes, but only provided in respect of corporate bodies

3.9.37 Further information on the enforcement options provided to the Sheriff are detailed below.

Imprisonment

3.9.38 While the Sheriff has the power to imprison offenders, this power is only exercised as a last resort. It is not seen as cost-effective as the State forgoes the cash penalty and also incurs the cost involved in detaining the offender.

Suspension of driver licence/motor vehicle registration

Driver licence

3.9.39 The Road Safety (Procedures) (Amendment No. 3) Regulations 1989 provided VicRoads with the power to suspend a person's licence to drive a motor vehicle where a fine has not been paid in relation to a motor vehicle related offence. This power was not put into effect until April 1992 when VicRoads delegated the power to an officer within the Department of Justice. In the following 10 month period, 3 800 offenders were threatened with suspension of their driver licence until the fine was paid. Only 57 per cent paid the fine which indicates that **licence suspension is not a totally effective method in obtaining payment of the fine.** The remaining 43 per cent had their driver licences suspended until such time as either all unpaid fines are paid or an instalment payment arrangement is approved.

Motor vehicle registration

3.9.40 The Sheriff was provided with the power to suspend the registration of a motor vehicle registered in the name of a corporate body, where *owner onus* applies. However, the power to suspend the registration of a vehicle registered in the name of an individual was not given.

3.9.41 In NSW, uncollected traffic and parking fines are referred by the Police and the Courts to the Road Traffic Authority for collection. The Authority has the power to cancel a driver licence or vehicle registration should payment not be made by a specified date. Furthermore, if fines are not paid, the registering authority will neither re-register nor record transfers relating to the vehicle until such time as payment is made.

3.9.42 In audit opinion, consideration should be given to adopting the NSW model of attaching outstanding warrants to driver licences and motor vehicle registrations to prevent renewal or transfer of ownership unless outstanding penalties are settled.

Seizure of personal property

3.9.43 The option to seize personal property was made available to the Sheriff only in respect of corporate bodies. Audit is pleased to note recent public statements of both the Attorney-General and the Sheriff of proposals to amend current legislation to allow for the seizure of individual offenders' property. While audit regards such a move as a positive step to reducing the level of unpaid fines, there remains the inherent problem that the offender must first be located.

3.9.44 However, in audit opinion, this proposed sanction would be effective in overcoming the problem of enforcement in instances where the offending vehicle is located but the offender's address is unknown. Consideration should also be given to registering the *interest* of the Sheriff on the VicRoads' Vehicle Securities Register, which records all registered third party interests in motor vehicles, to ensure that this measure is effective.

Inability to locate offenders

3.9.45 Location of offenders is an ongoing problem, and has contributed to the increase in uncollected fines, as the majority of warrants are returned by the Sheriff unexecuted due to the inability to locate offenders at the address given on the warrant. As summarised in Table 3.9G, statistics maintained by the Sheriff on the volume of warrants actioned indicates that on average, officers return 58 per cent of all warrants as unexecuted due to the inability to locate offenders.

TABLE 3.9G
WARRANTS RETURNED UNEXECUTED

	Total	Per cent
1990-91 -		
Warrants actioned	186 798	100
Warrants executed	79 996	42
Unexecuted	106 802	58
1991-92 -		
Warrants actioned	324 400	100
Warrants executed	129 802	40
Unexecuted	194 598	60
1992-93 -		
Warrants actioned	471 686	100
Warrants executed	205 283	43
Unexecuted	266 393	57

3.9.46 While the VicRoads database, which is motor vehicle related, is used by the Sheriff to establish the whereabouts of offenders, the fact that 58 per cent of warrants are returned unexecuted indicates that the database is not totally reliable. As stated previously, the unexecuted warrants represent offences committed by 107 879 individuals and entities, which is not a significant number in the context of VicRoads database as it holds information relating to 2.9 million driver licences on issue and 3.2 million vehicle registrations.

3.9.47 A review of the processes in place at VicRoads to record the name and address of driver licence holders and registered owners of motor vehicles indicate that the deficiencies may be due in part to the following:

- information provided to VicRoads, at the time motor vehicles are registered or driver licence obtained, are accepted at face value; and
- change of address is effected merely by notification with no requirement of proof.

3.9.48 While audit accepts that it is very difficult to obtain accurate address details from a person who has no intention of disclosing correct information, the absence of a reliable database means that the Sheriff must rely on other measures for the enforcement of warrants.

Timelag

3.9.49 Under the current enforcement system shown in Chart 3.9B, the timelag between the date an infringement notice is raised and the date a warrant is issued to the Sheriff by the PERIN Court is 119 days. The equivalent system in NSW allows 91 days. The extent of the timelag is a problem inherent in the existing enforcement system and has contributed to difficulties in locating offenders.

3.9.50 Audit found instances where local government agencies have further prolonged this timelag by delaying the filing of infringement notices with the PERIN Court. The payment by instalment arrangements offered to offenders by the PERIN Court, further adds to this timelag where offenders default on the arrangement. Audit analysis revealed that, in some instances, the timelag ranged between 5 and 11 months.

3.9.51 Given that the offender was originally allowed 28 days to settle the infringement notice, the fact that a further 91 days is allowed to elapse appears overly generous. Audit is of the view that consideration should be given to shortening the processes within the enforcement system for the settlement of outstanding fines.

Action taken by the Sheriff to improve productivity

3.9.52 Despite the constraints detailed above, statistics maintained by the Sheriff indicate that in the period 1990-91 to 1992-93 there has been a substantial increase in productivity, as indicated in Table 3.9H, which sets out the ratio of warrants actioned and executed to the number of staff employed.

TABLE 3.9H
RATIO OF WARRANTS ACTIONED AND EXECUTED TO STAFF

	<i>Total criminal warrants</i>		<i>Total staff</i>	<i>Ratio to staff of warrants</i>	
	<i>Actioned</i>	<i>Executed</i>		<i>Actioned</i>	<i>Executed</i>
1990-91	186 798	79 996	319	585	251
1991-92	324 400	129 802	314	1 033	413
1992-93	471 686	205 293	291	1 621	705

3.9.53 The improved performance is attributable in part to the following strategies developed by the Sheriff:

- Issue of standard letters informing offenders that the Sheriff is holding a warrant which enables contact with the offender without the need for a visit by a field officer. In 2 divisions, this technique increased execution rates by 10 per cent and reduced travelling costs by 50 per cent;
- "Open hours" of work to enable higher offender contact. In one division this technique increased offender contact and contributed to increased execution rates of approximately 33 per cent;
- Targeting areas and offender groups which improved the execution rates of one division by 50 per cent;
- Check of the offender address on VicRoads database prior to execution of warrants by one division improved execution rates by 50 per cent and reduced travelling expenses by an average of 20 per cent; and
- Establishment of an in-house instalment payment scheme by one division which was adopted by the Sheriff. This initiative allows for the collection of the execution cost which would not have been collected had the offender sought an instalment arrangement from the PERIN Court.

The success of the above measures is commendable.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

Report	Subject	Status at date of preparation of this Report
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MATTERS RESOLVED OR ACTION COMMENCED

DEPARTMENT OF JUSTICE

<p><i>Ministerial Portfolios, May 1989, pp. 54-6. May 1993, pp. 203-13.</i></p>	<p>There is a need to review various aspects of operations and administration of the Residential Tenancies Fund, including obtaining agreements with banks to obtain high interest returns for the Fund.</p>	<p>Actions taken within the Department include:</p> <ul style="list-style-type: none"> ▪ negotiation with major banks, within the present legislative framework, to obtain the best possible terms and conditions on bond moneys deposited; and ▪ a committee of government members established by the Minister is working with the Office of Fair Trading and Business Affairs to produce a recommendation for the further management of tenant bonds.
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ESTATE AGENTS BOARD

<p><i>Ministerial Portfolios, May 1993, pp. 183-93.</i></p>	<p>The Board's ability to negotiate more favourable dealings with financial institutions so as to generate additional income is limited by legislation.</p>	<p>A joint Board/industry working party reviewing the Estate Agents Act recommended to the Minister for Fair Trading that the restrictive legislation be repealed.</p>
	<p>There is a need to improve the timeliness of processing licence applications and renewals by delegating the power to grant licences.</p>	<p>An internal reorganisation of the operations and responsibilities of the Board and its standing committees will shorten the time for the granting of licences. The Board/industry working party has recommended legislative amendments to the Minister for Fair Trading.</p>

OFFICE OF THE CHIEF COMMISSIONER OF POLICE

<p><i>Ministerial Portfolios, May 1993, pp. 214-19.</i></p>	<p>The absence of an adequate management information system to determine the total costs of police deployed at sporting and entertainment events.</p>	<p>Improved accountability and a management trail will be provided as soon as policies and procedures are developed and promulgated.</p>
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STATE ELECTORAL OFFICE

<p><i>Ministerial Portfolios, May 1993, pp. 193-202.</i></p>	<p>Negotiations to be concluded with various parties to effect cost savings through the introduction of alternative State electoral roll maintenance process.</p>	<p>The Office is conducting a pilot study of its alternate electoral roll maintenance process, and is keeping the Australian Electoral Commission informed of the study.</p>
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SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED - continued

STATE ELECTORAL OFFICE - continued

<i>Ministerial Portfolios, May 1993, pp. 193-202.</i>	<p>The collection of electoral fines relating to the October 1992 State election will result in a net cost to the State of around \$670 000. Given this cost, there is a need to review related legislative provisions, with a view to improving the efficiency of current collection procedures and re-assessing the level of fines imposed.</p> <p>Deficiencies in the current information systems, including associated development and maintenance procedures need to be addressed.</p>	<p>In his Report to Parliament on the Administration of the 1992 Victorian State Election, the Electoral Commissioner recommended legislative amendments so that electors who fail to vote, without having a valid and sufficient excuse, can be dealt with through the PERIN (Penalty Enforcement by Registration of Infringement Notice) system.</p> <p>The Office is taking action to address the deficiencies.</p>
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SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
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COMPLETED AUDITS

Department of Justice	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	25 Oct. 1993	27 Oct. 1993
ATTORNEY-GENERAL				
Estate Agents Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	16 Sept. 1993	17 Sept. 1993
Guardianship and Administration Board	30 June 1993	" "	28 Sept. 1993	28 Sept. 1993
Law Reform Commission of Victoria (a)	period ended 24 Nov. 1992	" "	31 Mar. 1994	27 April 1994
Legal Aid Commission of Victoria	30 June 1993	" "	28 Sept. 1993	30 Sept. 1993
Legal Aid Commission Staff Superannuation Fund	30 June 1993	30 Sept. <i>Legal Aid Commission Act 1978, s.42.</i>	28 Sept. 1993	30 Sept. 1993
Office of the Director of Public Prosecutions	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	9 Sept. 1993	14 Sept. 1993
Office of the Public Advocate	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	27 Sept. 1993	28 Sept. 1993

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - continued

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS - continued				
ATTORNEY-GENERAL - continued				
Senior Master of the Supreme Court (b)	31 Dec. 1992	No statutory requirement.	25 Nov. 1993	28 Jan. 1994
State Electoral Office	30 June 1993	" "	10 Sept. 1993	22 Sept. 1993
State Trust Corporation of Victoria	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	29 Sept. 1993	30 Sept. 1993
Victorian Financial Institutions Commission	30 June 1993	" "	24 Sept. 1993	24 Sept. 1993
Victorian Institute of Forensic Pathology	30 June 1993	" "	28 Sept. 1993	29 Sept. 1993
CORRECTIONS				
Victorian Prison Industries Commission	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	29 Sept. 1993	29 Sept. 1993 (c)
POLICE AND EMERGENCY SERVICES				
Country Fire Authority	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	20 Sept. 1993	21 Sept. 1993
Metropolitan Fire Brigades Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	20 Sept. 1993	20 Sept. 1993
National Institute of Forensic Science	30 June 1993	No date specified. <i>Audit Act 1958, s.3.</i>	7 Feb. 1994	15 Feb. 1994
National Police Ethnic Advisory Bureau	30 June 1993	" "	2 Feb. 1994	16 Feb. 1994
Office of the Chief Commissioner of Police	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	21 Oct. 1993	21 Oct. 1993

(a) The Law Reform Commission was abolished on 24 November 1992.

(b) Senior Master of the Supreme Court produces financial statements which are not a statutory requirement but are audited by arrangement.

(c) Qualified audit report issued.

Part 3.10

Planning and Development

KEY FINDINGS

DEPARTMENT OF PLANNING AND DEVELOPMENT

Financial operations of the Home Opportunity Loans Scheme

- At December 1993, the State's net financial contribution to the Home Opportunity Loan Scheme (HOLS) totalled \$34.1 million.
Paras 3.10.13 to 3.10.16
- During 1994, the Department will increase the amount set aside, to meet any future cash flow difficulties that HOLS may encounter, to \$101 million.
Paras 3.10.16 and 3.10.33
- The realised losses incurred by HOLS from discharged mortgages between 1989 and 1993 totalled \$8.5 million. The ongoing incidence of such losses, which occurred due to borrowers defaulting on loan repayments, has now become a significant factor impacting on the level of financial support that may be required by HOLS in future years.
Paras 3.10.18 to 3.10.20
- The significant fall in market interest rates in recent years, combined with an increased number of mortgage discharges and reduced demand for HOLS loans, has resulted in insufficient investment returns being generated to cover the cost of the Scheme's debt.
Paras 3.10.21 to 3.10.24
- The total number of HOLS loans in arrears and those subject to special repayment arrangements represented 11.3 per cent of the Scheme's total loan portfolio, or 1 400 loans.
Paras 3.10.25 to 3.10.27
- Due to HOLS non-competitiveness and the high fixed cost of its debt, the Government in January 1994 announced its intention to restructure the Scheme. It was estimated that the restructure will reduce the call on funds set aside by the Department by \$21 million.
Paras 3.10.28 to 3.10.34

KEY FINDINGS - continued

Municipal enterprise projects

- The Office of Local Government and the Department of the Treasury need to formalise and document the nature and extent of checks undertaken when assessing council proposals for municipal enterprise projects and monitoring such projects.

Paras 3.10.48 to 3.10.50

- The Government needs to firmly establish whether the monitoring of municipal enterprise projects extends beyond the mere monitoring of the progress of projects to a more pro-active role of identifying potential risks. If an expanded role is accepted, existing monitoring processes need to be enhanced. If not, audit questions the value of the limited oversight currently being exercised in respect of such projects.

Para. 3.10.51

URBAN LAND AUTHORITY

Financial implications of The Mews joint venture redevelopment

- To ensure that a joint venture project known as *The Mews* proceeded, the Urban Land Authority substantially accepted responsibility for the financial risks of the project without revision of the profit-sharing arrangements. This included the provision, at no cost, of a guarantee to enable the developer to obtain finance amounting to \$8.6 million for the project.

Paras 3.10.59 to 3.10.65

- The overall financial result for the Authority from participation in the joint venture project is anticipated to be a marginal net return of around \$100 000 even though the Authority's contribution comprised the development sites and related costs of \$1.7 million and \$600 000, respectively, and a guarantee to the developer's financier of \$8.6 million.

Paras 3.10.66 to 3.10.68

3.10.1 Four Ministers, namely the Minister for Housing, the Minister for Local Government, the Minister for Major Projects and the Minister for Planning, have responsibility for operations within the Planning and Development sector. These Ministers have collective responsibility for the Department of Planning and Development.

3.10.2 Details of the specific ministerial responsibilities for public bodies within the Planning and Development sector are listed below in Table 3.10A. These public bodies, together with the Department of Planning and Development, are subject to audit by the Auditor-General.

**TABLE 3.10A
MINISTERIAL RESPONSIBILITIES WITHIN THE
PLANNING AND DEVELOPMENT SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Housing (a)	-
Local Government	City of Melbourne Superannuation Fund
Major Projects	Docklands Authority
Planning	Architects Registration Board of Victoria Historic Buildings Council Loddon-Campaspe Regional Planning Authority Plumbers, Gasfitters and Drainers Registration Board Upper Yarra Valley and Dandenong Ranges Authority Urban Land Authority

(a) Minister has responsibility for certain functions of the Department of Planning and Development.

3.10.3 Comment on matters of significance arising from the audit of certain of the above entities is provided below.

DEPARTMENT OF PLANNING AND DEVELOPMENT

FINANCIAL OPERATIONS OF THE HOME OPPORTUNITY LOANS SCHEME

3.10.4 Since the 1950s, Victorian governments have supported various financing schemes aimed at providing home ownership opportunities for low to middle-income earners unable to obtain finance from traditional lending sources. Since 1988, the major vehicle used to provide such home ownership assistance has been the Home Opportunity Loans Scheme.

3.10.5 The previous 2 *Reports on Ministerial Portfolios* have commented on the continuing incidence of loans in arrears and those subject to special repayment arrangements, losses from property sales and the escalating level of doubtful debts that have necessitated the ongoing provision of financial support by the State to the Scheme to ensure that it remains viable.

3.10.6 In addressing the Scheme's financial problems, the Department of Planning and Development in previous years has implemented various initiatives aimed at:

- alleviating the financial hardship experienced by many of the Scheme's borrowers;
- improving the management of loan arrears;
- exploring the scope for revised funding arrangements to reduce the Scheme's borrowing costs; and
- increasing borrower awareness of their loan obligations.

3.10.7 Notwithstanding these initiatives, the substantial cost to the State of the Scheme, due to the high cost of debt to fund the Scheme together with the growing number of borrowers refinancing loans or defaulting on loan repayments, and the declining demand for loans due to the availability of other sources of home finance at lower rates of interest, prompted an announcement by the Government in January 1994 that the Scheme would be restructured.

3.10.8 The following paragraphs outline the current financial operations of the Scheme and the key factors which necessitated its restructure.

Operations of the Scheme

3.10.9 The Scheme was established by the Government in 1988 and is administered by Home Opportunity Loans Limited through the Home Opportunity Loans Trust, with the Department having responsibility for monitoring the Scheme's performance on behalf of the Government. The company and the Trust are effectively controlled by the Department as it has the capacity to dominate decision-making in relation to these entities' financial and operating activities. A second private company has been engaged by the Trust to manage the Scheme's loan portfolio and independent retailers, such as banks and building societies, are employed by this company to provide and manage loans. One of the retailers is the Department.

3.10.10 Under the financial arrangements entered into between the Department and the companies involved in the administration of the Scheme, the Department is required to provide the necessary financial support to the Scheme if it is unable to meet its debt servicing obligations or operating costs. Funding is also provided by the Department for interest subsidies in respect of those loans provided at concessional interest rates, which represent around 8 per cent of the Scheme's total loan portfolio. Accordingly, the companies do not have any financial exposure under the arrangements.

3.10.11 The predominant type of assistance available under the Scheme, prior to its restructure, was the standard home opportunity loan, which offered fixed and indexed interest home finance, with loan funds provided for up to 95 per cent of the value of properties. As the loan instalments for the first half, and in some cases up to two-thirds, of the loan period (maximum 25 to 30 years) did not cover the interest chargeable on these loans, the amount owing escalated over this period. However, loan instalments were increased annually, irrespective of whether or not the borrowers' income increased.

3.10.12 At December 1993, the Scheme had approximately 12 400 current loans, secured by residential mortgages, with a value outstanding in excess of \$741 million (December 1992, 14 090 loans, value outstanding \$878 million).

Contributions to the Scheme by the State

3.10.13 Net contributions made by the State to the Scheme in the form of interest subsidies and operating support, from the Scheme's inception in July 1988 to December 1993, totalled \$34.1 million. Details are outlined in Table 3.10B.

TABLE 3.10B
STATE CONTRIBUTIONS TO THE SCHEME, JULY 1988 TO DECEMBER 1993
(\$million)

Item	1988-89	1989-90	1990-91	1991-92	1992-93	1/7/93 - 31/12/93	Total
Contributions -							
Interest subsidies	1.4	4.2	4.6	6.1	6.0	(a) 1.1	23.4
Operating support	0.2	2.3	1.2	7.3	1.7	(b) 0.1	12.8
Total annual contributions	1.6	6.5	5.8	13.4	7.7	1.2	36.2
Less distributions from Trust	0.2	1.6	0.2	0.1	-	-	2.1
Net contribution (c)	1.4	4.9	5.6	13.3	7.7	1.2	34.1

(a) Budget for 1993-94 is \$4 million.

(b) Budget for 1993-94 is \$5 million, including \$3 million for realised losses.

(c) These figures exclude the cost of the Department's Home Finance Division's activities relating to the administration of the Scheme.

3.10.14 To 31 December 1993, subsidies totalling \$23.4 million had been provided to the Scheme by the Department to cover interest costs incurred by the Scheme in respect of borrowers who had been granted loans at concessional rates of interest for the first 3 years of the loan period. In accordance with a change in government policy, from 1 July 1993, these subsidies have been funded directly by the Department from its internally-generated funds rather than from Parliamentary Appropriations.

3.10.15 In addition, operating support is provided by the Department to cover any shortfalls where the Scheme's income, which is primarily generated from loan repayments, is insufficient to meet debt servicing obligations and operating costs. To 31 December 1993, such operating support provided by the Department totalled \$12.8 million.

3.10.16 Further to the above financial contributions, and consistent with the accepted practice of lending institutions, funds have been set aside by the Department in a specific purpose capital support account to meet any future losses incurred by the Scheme, including funds for bad debts. Following a preliminary review by the Department of various capital adequacy rates applied by lending institutions, **the level of funds set aside was increased from \$45 million at December 1992 to \$67.5 million at 31 December 1993. The Department budgeted for a further \$13.5 million to be set aside in 1994.**

□ RESPONSE provided by Secretary, Department of Planning and Development

As a result of a report by banking consultants, Bessemer O'Duill, in early 1992, which recommended the adoption of the Reserve Bank of Australia capital adequacy requirements for bank mortgage portfolios set at a minimum of 4 per cent of assets, the Department established a capital support account for prudential purposes.

The Department estimates that by 30 June 1994 the amount in the capital support account will be approximately \$100 million.

Losses of the Scheme will firstly be met from the provisions made under the Scheme for bad and doubtful debts of \$11.2 million and interest deferral of \$1 million for non-performing loans. Recourse to the Consolidated Fund is not anticipated.

Any further losses would initially be met by changes to doubtful debts provisions with a resultant effect on profitability and subsequently require operating support by the Department as part of its agreed cash support role, (see Table 3.10B, State Contributions to the Scheme). If further support was required, including losses as a result of the restructure of the Scheme announced by the Government, then potentially there would be a call on the capital support account.

3.10.17 The following major factors have impacted on the level of State contributions to the Scheme.

Significant increase in losses from property sales

3.10.18 Losses incurred by the Scheme following the discharge of mortgages by the Home Opportunity Loans Trust, necessitated by borrowers defaulting on loan repayments due to financial difficulties and the subsequent sale of properties, have increased significantly in recent years, particularly in the 6 months to 31 December 1993. Table 3.10C shows the extent of such losses since 1989-90.

**TABLE 3.10C
LOSSES FROM FORCED PROPERTY SALES,
1989-90 TO DECEMBER 1993**

<i>Financial year</i>	<i>Mortgages</i>	<i>Total loss</i>	<i>Average loss per property</i>
	<i>(no.)</i>	<i>(\$)</i>	<i>(\$)</i>
1989-90	5	28 673	5 735
1990-91	20	296 246	14 812
1991-92	75	1 570 928	20 946
1992-93	153	3 059 067	19 994
1/7/93 - 31/12/93	(a) 169	(b) 3 526 752	20 868
Total	422	8 481 666	20 099

(a) At December 1993, a further 47 mortgages were expected to be discharged resulting in estimated losses of \$1.1 million.
 (b) Budget for 1993-94 is \$3 million.

3.10.19 The main reason for the above losses from forced property sales is the continuing static property values which, combined with escalating outstanding loan balances caused by the deferral of interest payments, resulted in particular loan balances exceeding the current value of the properties at the time mortgages were called-up or surrendered and the properties sold.

3.10.20 The extent of realised losses from discharged mortgages incurred by the Scheme during the 6 months ended December 1993 of \$3.5 million, has been the major factor contributing to the Scheme's operating loss, which has been calculated at \$2.8 million for the same period. Indeed, **the Department acknowledged that the ongoing incidence of such losses has now become a significant factor impacting upon the level of State financial support that may be required in future years to ensure the Scheme's continued financial viability. This is reflected in the significant amount which has been set aside by the Department in its capital support account.**

□ RESPONSE provided by Secretary, Department of Planning and Development

The underlying reason for losses associated with the Scheme has been the difficult economic climate in Victoria, which has resulted in significant job losses, reduced income and caused financial stress for borrowers. This adverse climate has resulted in increased arrears, defaults under the mortgages and ultimately forced sales of security properties in a static or declining property market.

Cost of Scheme's debt

3.10.21 The financial assistance provided to borrowers by the Scheme has been funded from the issue of housing bonds by Victorian Housing Bonds Ltd, the proceeds of which were on-lent to the Home Opportunity Loans Trust. These bonds were issued between 1988 and 1992 at the prevailing fixed market rates of interest, which are also reflected in the Scheme's debt costs and lending rates.

3.10.22 Funds accumulated by the Scheme (\$134 million at December 1993) have been affected by the number of voluntary mortgage discharges and a reduced demand for loans. As market interest rates have fallen significantly in recent years, these accumulated funds have not generated sufficient investment returns to cover the cost of the Scheme's debt. At December 1993, the Scheme's debt totalled \$893.9 million.

3.10.23 In the period July 1992 to December 1993, 3 021 loans valued at \$220.7 million have been discharged. These comprised 251 loans valued at \$15.4 million which were discharged by the Home Opportunity Loans Trust as a result of borrowers defaulting on loan repayments, in addition to a further 2 770 loans valued at \$205.3 million which were voluntarily discharged by borrowers. These latter borrowers were able to refinance their loans with other lending institutions which offered more competitive interest rates, or sold their properties and paid out their loans with the proceeds of sale.

3.10.24 The Department advised that due to the significant number of mortgages discharged over the 18 month period to December 1993, it was estimated that the Scheme would generate \$19 million less interest income annually up until 1996-97. In these circumstances, unless interest rates increase consistent with those relating to the housing bonds issued, it is likely that the Scheme will require financial operating support from the State to cover this shortfall in interest income.

Increase in the level of loans in arrears

3.10.25 The total number of loans in arrears and those subject to special repayment arrangements increased from around 1 270 at December 1992 to 1 400 at 31 December 1993, and represented 11.3 per cent of the total loan portfolio (9 per cent, 31 December 1992). However, closer monitoring by the Department of these loans has contributed to a reduction in the level of arrears in excess of 3 months. The Department is also currently considering the appointment of a debt recovery agent with a view to minimising losses from mortgage discharges.

3.10.26 While the Scheme's loan portfolio is managed by a private company on behalf of the Home Opportunity Loans Trust, the Department, as one of the retailers engaged by the company, has direct responsibility for the day-to-day administration of a portion of the portfolio. At 31 December 1993, the Department was responsible for the administration of in excess of 3 200 loans valued at \$146.7 million, representing 23 per cent of the Scheme's loan portfolio.

3.10.27 The audit revealed that the performance of the Department in managing and controlling the incidence of loans in arrears and those subject to special repayment arrangements improved over the 12 month period to 31 December 1993 and was consistent with that of the other retailers. This result was primarily attributable to the adoption of more commercially-based arrears management procedures over this period, which incorporate closer monitoring and follow-up of loans in arrears.

Restructure of the Scheme

3.10.28 As previously mentioned, a number of factors have necessitated the provision of financial support by the State in order to ensure the Scheme's continued viability. These included the increasing incidence of losses arising from the discharge of mortgages, borrowers refinancing their loans from other sources and escalating doubtful debts, and the high fixed costs associated with the Scheme's debt.

3.10.29 In recognition of these problems, over recent years several reviews were initiated by the Department culminating in a range of corrective actions. However, **due to the high fixed cost of the Scheme's debt and the Scheme's non-competitiveness, the Government, in January 1994, announced its intention to restructure the Scheme by:**

- Offering a range of loan products, reflecting current market interest rates, to existing borrowers effective from 1 March 1994. The Department anticipates that, provided current economic conditions prevail, over 60 per cent of borrowers are likely to benefit from the more favourable loan terms, which include a reduction in interest rates chargeable;
- Providing further financial support to borrowers continuing to suffer from a loss or reduction in income through unemployment and illness;
- Reviewing the existing arrangements for the sharing of home ownership costs such as property maintenance and insurance; and
- Developing strategies to better manage the nature and cost of the Scheme's debt.

3.10.30 In addition, as part of the restructure, the Department in conjunction with the Treasury Corporation of Victoria and the Department of the Treasury during 1994 proposes to develop and implement a financial risk management strategy aimed at minimising the Scheme's costs. Furthermore, the Department proposes to:

- re-examine funding sources for its capital support account;
- incorporate commercially-based prepayment fees for the early repayment of loans to stem the extent of future loan prepayments; and
- examine the feasibility of the Government acquiring the companies associated with the Scheme.

3.10.31 This restructure program aims to stabilise the financial base of the Scheme by reducing the incidence of early repayment of loans by borrowers which impacts adversely on the Scheme's operating costs and by addressing the problem of growing loan balances for a substantial number of borrowers. Concurrent with the implementation of the Scheme's restructure program, the Government plans to review the appropriateness and nature of its future involvement in home finance schemes.

3.10.32 The Department estimated that if no action was taken to address the Scheme's financial problems, the funds to be set aside in its capital support account totalling \$81 million (\$67.5 million at 31 December 1993 and a further \$13.5 million budgeted for in 1994), would have been exhausted by the year 2000. However, **after taking into account the effect of the restructure, the Department has estimated the future net call by the Scheme against the capital support account to the year 2 000 will be \$60 million, representing a \$21 million reduction compared with the situation which would have arisen if no corrective action had been taken.**

3.10.33 To maintain adequate capital support for the Scheme, the Department, as part of the restructure, plans to provide a further \$20 million to be paid into the capital support account, bringing the total support to \$101 million

3.10.34 While audit acknowledges the positive action initiated by the Government to redress the Scheme's declining financial position, there is a need for the results of the restructure to be closely monitored by the Department to ensure that the State's financial exposure to the Scheme is minimised.

MUNICIPAL ENTERPRISE PROJECTS

3.10.35 In 1987, in recognition of the increased participation of municipal councils in commercially-based developments with the private sector, and the associated financial risks to local communities from such participation, the *Local Government Act* 1958 was amended to require councils to obtain the approval of the Minister for Local Government and the Treasurer **prior to proceeding with such projects**.

3.10.36 To administer the new requirement, the former Department of Local Government and the Department of the Treasury both established units with specific responsibility for approving and monitoring, on an ongoing basis, municipal enterprise projects. In April 1988, the Auditor-General reported to the Parliament on the results of an audit review of the Department of Local Government's role in approving and monitoring these projects. The Auditor-General's Report concluded that "... while guidelines had been set down for evaluating ventures to the approval stage, procedures had not been finalised for continuous, ongoing project monitoring by the Department".

3.10.37 The *Local Government Act* 1989 which replaced the 1958 Act required councils to obtain the approval of both the Minister for Local Government and the Treasurer **before entering into enterprise projects**. The revised legislation removed an anomaly which had enabled councils to enter into agreements prior to obtaining relevant ministerial approvals.

3.10.38 In 1993, at the request of the Minister for Local Government, the Auditor-General undertook a review of an enterprise project involving the City of Footscray. In relation to the role of the Office of Local Government in this project, audit concluded that greater attention needed to be given to more thorough evaluations of the costs and benefits of proposals submitted by councils prior to the approval of the proposal, together with strong on-going monitoring of approved projects by all parties involved, including the relevant council, the Office and the Department of the Treasury.

3.10.39 To assist in this process, audit recommended that consideration be given to the development of central guidelines which set out the responsibilities of all parties, namely:

- the form and method of financial analyses required prior to the approval of any proposals by the relevant ministers;
- reporting requirements by councils to central agencies on the progress and outcomes of approved projects; and
- requirements for monitoring by central agencies, including any need for site visits, examinations of relevant financial records and evaluations of outcomes against those anticipated.

3.10.40 Subsequent to that review, the Office advised audit that it has put in place a more rigorous system to monitor approved projects.

3.10.41 Up until 31 December 1993, a total of 57 enterprise projects had been approved by both Ministers since the enactment of the 1987 legislative requirements. Of these projects, 9 have been completed, 6 abandoned and 42 are still in progress. The projects in progress were valued at \$879 million, with councils having equity in these projects to the value of \$105 million. According to the Office, only 3 major projects have encountered difficulties since 1987, necessitating closer scrutiny by that Office. However, currently only one project valued at \$15 million, with council equity of \$4 million, is subject to close monitoring by the Office.

Approval and monitoring processes

3.10.42 As previously mentioned, under the *Local Government Act* 1989, the Office and the Department of the Treasury have joint responsibility for approving proposed municipal enterprise projects. This role also involves the provision of guidance to councils in preparing submissions for approval.

3.10.43 In broad terms, the principal aim of the 2 agencies, as advised to audit, is to examine the financial viability of proposed projects, including the potential liabilities and risks, and to determine whether the projects can be undertaken without exposing councils to financial risk. The Office, in conjunction with the Department, have issued guidelines which outline the type of information councils should consider submitting to support each proposed project. These include:

- an outline of the project and its objectives;
- the legal relationship between the council and its private sector partner, including details of proposed corporate structures;
- background on the private sector partner, including past involvement in similar projects and its current financial position;
- a business plan and a sensitivity analysis which incorporates a financial appraisal, a marketing strategy, and implementation and operational plans for the project;
- the risk exposure to the council, including any guarantees to be provided;
- an outline of the non-financial benefits which are anticipated to be realised from the project;
- copies of all relevant legal agreements; and
- the monitoring and reporting arrangements to be established by the council to oversee the project.

3.10.44 The Office undertakes an assessment of the financial viability of proposed projects, which includes a review of the related financial arrangements and cost-benefit projections. The Department of the Treasury also undertakes a similar assessment and attempts to quantify the maximum potential financial exposure that could be incurred if proposed projects could not be completed or had to be abandoned. The Department also assesses, where appropriate, the impact of projects on the State's Loan Council borrowing allocations as local council borrowings fall within this allocation.

3.10.45 Following completion of each agency's assessment, council proposals which are regarded as acceptable are presented to both the Minister for Local Government and the Treasurer for formal approval. Each ministerial approval stipulates that:

"... it does not and cannot represent a guarantee or acceptance of responsibility by the State government in relation to liabilities incurred, or in relation to any aspects of the project or of future funding of the proposal".

3.10.46 Under the established project monitoring processes, councils are required, as a condition of the ministerial approvals, to submit to the Office throughout the period of council involvement either quarterly, bi-annually or annually, reports on the progress of each project. These progressive reports are aimed at assisting the Office to ascertain whether projects are progressing as planned in terms of their financial targets and completion timeframes. The reports are also aimed at ensuring councils promptly identify any problems encountered and that corrective action has been initiated to overcome the problems on a timely basis. In addition, councils are required to seek Ministerial approval for any major variations to projects.

3.10.47 To assist in monitoring the progress of projects, the Office in conjunction with the Department recently designed a proforma report to standardise the information provided by councils for monitoring purposes. The Office's information system has also been enhanced to assist in identifying instances where progress reports have not been received from councils so that follow-up action can be taken by that Office.

Effectiveness of existing processes

3.10.48 Since the introduction of legislation in 1987 which established a framework to control council involvement in enterprise projects by requiring ministerial approval prior to entering such projects, the potential to expose councils to financial difficulties has been reduced. However, the audit review identified certain shortcomings relating to documentation to support project approvals, and project monitoring processes which reduced the effectiveness of the role of government, in terms of minimising any potential risks to councils and the State.

3.10.49 Details of these shortcomings are outlined below:

- Formal guidelines have not been established which set out the nature and extent of checks to be performed by the 2 agencies when assessing information provided by councils to support project proposals. Furthermore, details of the actual checks performed and outcomes thereof, are not always documented on the relevant departmental project files. In these circumstances, inconsistencies could arise in the type and extent of checks performed, particularly in the event of a change in personnel. In the event that projects subsequently encounter difficulties which pose risk to councils or the State, without adequate evidence, it may be difficult for the agencies to demonstrate that due care was exercised when assessing proposals; and
- Monitoring of the progress of projects generally involves the review of progress reports submitted by councils. The Office is heavily reliant on councils to identify potential problems in these reports and does not undertake a more hands-on monitoring role due to resource constraints. Thus, the Office may not be in a strong position to pre-empt or identify potential problems at an early stage, such as failure to achieve financial targets or meet completion dates.

3.10.50 While a government framework for assessing and monitoring the financial viability of enterprise projects has been established, given the shortcomings outlined above, further scope exists to enhance the effectiveness of the existing assessment and monitoring processes. Specifically, **the Office of Local Government and the Department of the Treasury need to formalise and document the nature and extent of checks undertaken when assessing council proposals and monitoring projects.**

3.10.51 Furthermore, the Government needs to firmly establish whether the monitoring role extends beyond the mere monitoring of the progress of projects to a more pro-active role of identifying potential risks. If an expanded role is accepted, existing monitoring processes need to be enhanced to facilitate more timely and detailed assessments of the progress of projects including their financial status. If not, audit questions the value of the limited oversight currently being exercised in respect of municipal enterprise projects.

□ **RESPONSE** provided by Secretary, Department of Planning and Development

It is pleasing to see that audit has recognised the improvements already made by the Office and the Department to their monitoring procedures in response to an earlier audit report. Audit's latest comments regarding the extent of resources used in monitoring projects have been noted. However, as acknowledged by audit, the level of monitoring is a policy decision for the Government.

In this latest review, audit has raised a new aspect with its suggestion that the lack of formal guidelines on the nature and extent of checks is a shortcoming in the 2 agencies' assessment procedures. It is understood that audit's concerns relate mainly to files on municipal enterprises assessed prior to 1992. The 2 agencies have improved assessment procedures and documentation, both in response to earlier audit suggestions and on their own initiative, to the extent that the Office considers that file documentation does demonstrate that necessary checks are done on municipal enterprise proposals. Nevertheless, the Office notes audit's suggestion that file documentation could be improved further by the adoption of formal guidelines. The Office is taking steps to address audit's concerns and will seek the assistance of audit on the preparation of these guidelines.

Audit's Report also refers to potential risks to the State. Treasury and the Office are concerned with liabilities that may fall on the public sector. However, as reported by audit, in granting approval for a council to undertake a municipal enterprise, the Minister for Local Government and the Treasurer specifically do not guarantee or accept responsibility for any liabilities incurred by a council in relation to the enterprise. In addition, previous reports prepared by audit on 2 municipal enterprise projects clearly conclude that no financial liability falls on the State as a result of the ministerial approvals. Accordingly, the basis of the concerns of audit regarding risk are unclear.

□ **RESPONSE** provided by Secretary, Department of the Treasury

The review identified issues relating to various administrative arrangements within the Department of the Treasury. In broad terms, these issues related to the formalisation of the roles of both the Department and the Office of Local Government in the section 193 approval process, the level of documentation of checks conducted by the 2 Departments prior to the approval of proposals and the re-establishment of a monitoring system to check the progress of projects through a more pro-active role of identifying potential risk.

While there was general agreement with audit to formalise the role and practices of the 2 departments, a difference of views remained in relation to the monitoring process.

It has been a long held government view that the individual municipality entering an enterprise project has prime responsibility for the operation and success of the project. In granting approval for the municipality to enter into such a project, the Treasurer and the Minister for Local Government specifically do not guarantee or accept responsibility in relation to any liabilities incurred in the project. Any monitoring undertaken should be consistent with this view.

Treasury is concerned with liabilities that may be accepted by the public sector and with Loan Council matters generally. Treasury is also interested in verifying that commercial undertakings entered into in the public sector are in fact financially viable. For these purposes, Treasury should have the benefit of an effective monitoring system. However, Treasury does not and should not intrude into the activities of individual municipalities.

URBAN LAND AUTHORITY

FINANCIAL IMPLICATIONS OF THE MEWS JOINT VENTURE REDEVELOPMENT

3.10.52 The Urban Land Authority was established under the *Urban Land Authority Act* 1980 primarily to facilitate the development of urban residential land for retail sale and the disposal of land surplus to government needs. The Authority also has responsibility for assisting in the implementation of State urban planning policies, which is discharged through the provision of housing opportunities in the metropolitan area and the stimulation of private sector investment in housing. In April 1994, the Government announced its intention to corporatise the Authority.

3.10.53 Since 1980, the Authority's core business has been to develop residential land in the outer-metropolitan areas for sale to the public, usually first home buyers. However, during 1992-93, as part of its redevelopment activities in established inner-urban areas, the Authority entered into 4 joint venture arrangements with private sector developers. Generally, these arrangements provide for the Authority to contribute land and the developers to undertake unit construction and to subsequently sell the units to the public. **Returns to the Authority are based upon a profit-sharing formula agreed for each project.** At December 1993, the Authority had contributed land valued at \$2.7 million to the 4 joint ventures.

3.10.54 To enable the first joint venture redevelopment to proceed, it was necessary for the Authority, in contrast to the other redevelopments, to accept substantially the financial responsibility for the project. Details of this joint venture, which is referred to as *The Mews*, are outlined in the following paragraphs.

The Mews

3.10.55 Planning for the Mews redevelopment commenced in February 1989 with the identification by the Authority of 2 sites covering an area of 0.7 hectares in East Melbourne, designated as surplus government land, which had the potential for the development of innovative medium-density housing. One of these sites was formerly occupied by the Yarra Park Primary School and utilised for education purposes, with the other site comprising land not utilised when widening Punt Road.



The Mews Development, East Melbourne.

3.10.56 Consultants were engaged in August 1989 to assist the Authority in the conduct of a feasibility study which involved extensive consultation with planning authorities, the local council and residents, to assess development options for the sites that were consistent with the Authority's objective of assisting in the implementation of State urban planning policies. Following advice from the consultants that the potential development was "... *economically viable and satisfied the objectives of the Authority and interested groups*", in April and May 1991 the 2 sites were acquired by the Authority at a total cost of \$1.7 million.

3.10.57 In October 1991, the Authority invited interested parties to submit detailed proposals for the development of medium-density housing units on the sites through a joint venture arrangement. In April 1992, following evaluation by the Authority and its consultants of the proposals received, a preferred developer was selected to finance, construct and market 46 residential units on the Authority's land, at a cost of \$8.6 million.

3.10.58 In June 1992, the Authority received Ministerial approval to participate in the Mews redevelopment, its first joint venture arrangement. **A condition of such participation, established by the Authority, was that the developer, inter alia, had to satisfy the Authority of its financial viability and arrange suitable finance for the project on terms acceptable to both parties to the agreement.**

Financial exposure of the Authority

3.10.59 Following protracted negotiations on the financial arrangements, in March 1993 a development agreement was entered into by the respective parties. Under the agreement, which was conditional on the developer arranging suitable finance, the Authority was to receive:

- A joint venture fee of \$1.5 million payable in September 1994, representing the Valuer-General's valuation of the Authority's land at June 1992. This fee was \$200 000 below the purchase cost for the land as determined by the Valuer-General in April and May 1991; and
- A 50 per cent share of the first \$500 000 profit from property sales and a 25 per cent share of profits in excess of this amount.

3.10.60 When entering into this agreement, the Authority was aware of the fact that the projected returns from the project were marginal and that, in the event that the developer was unable to raise the required finance to enable the project to proceed, there would be a need for the Authority to increase its financial exposure.

3.10.61 As the developer was subsequently unable to arrange finance to meet the obligations under the agreement, in April 1993 a decision was made by the Authority to enter into a subsidiary agreement with the developer's financier, under which the financier was provided by the Authority with:

- an unconditional guarantee for the \$8.6 million loan facility required by the developer; and
- a first mortgage over the development sites.

3.10.62 Under these revised financial arrangements, which were sanctioned by the Minister, the Authority would be required to pay the financier an amount equivalent to the total outstanding borrowings including accrued interest if the developer defaults on his obligations to the financier. Alternatively, under the arrangements, the Authority could take over the loan facility and complete construction of the units. In accepting the increased financial exposure, the Authority considered that it was more feasible to assist in the development of the sites rather than attempting to sell the land in the current market and risk not recovering the value of its investment. Furthermore, the Authority believed that without the involvement of the State or some form of Government guarantee, financial institutions were unlikely to provide finance to private developers for inner-urban development projects.

3.10.63 In essence, to ensure that the project proceeded, the Authority substantially accepted responsibility for the financial risks of the project without revision of the profit-sharing arrangements. While acknowledging the arguments advanced by the Authority to support the provision of a guarantee, this additional financial support was given at no cost to the developer.

3.10.64 In order to reduce the financial risk associated with the project, the Authority implemented a number of sound management practices, including:

- engagement of independent quantity surveyors to assess and certify the builder's progress claims prior to the release of funds by the financier to the developer;
- establishment of a committee comprising representatives of the Authority, the developer and the financier to discuss relevant matters on a monthly basis;
- requirement for the annual accounts of the project to be audited by private practitioners; and
- assignment to the developer of the responsibility for managing the construction of the units within a fixed cost contract.

3.10.65 In addition, under the development agreement, there was a requirement that 20 per cent of the units were to be pre-sold prior to commencing their construction. Furthermore, the title to each unit was not to be transferred from the Authority until each unit was sold.

Financial returns to the Authority

3.10.66 At January 1993, the Mews project was expected by the Authority to generate a gross profit of \$2 million, with the Authority and the developer receiving \$600 000 and \$1.4 million, respectively. However, subsequent estimates prepared in December 1993, following the sale of 29 units which represented 54 per cent of the expected sales revenue, **forecast an increased gross profit of \$3 million, with the Authority and the developer's share being \$900 000 and \$2.1 million, respectively.**

3.10.67 Achievement of the forecast result will be dependent on the returns achieved from the sale of 2 luxurious units which represent 28 per cent of expected sales revenues from the 17 remaining unsold units, and the outcome of a potential claim by the developer for an additional \$500 000 for construction costs incurred to improve the quality of the completed units. Legal advice received by the Authority indicates that although the Authority is not bound to approve the developer's request for additional loan funds to meet these costs, it may be in its interests to consider doing so if the benefits of the additional works can be clearly established.

3.10.68 The Authority's contribution to the Mews project comprised the development sites and related costs, and the provision of a guarantee to the developer's financier for \$8.6 million. The overall financial result for the Authority from participation in the project is anticipated to be a marginal net return of around \$100 000. This result is determined after allowing for land acquisition costs of \$1.7 million and other related property costs of \$600 000, and taking into account the joint venture fee receivable of \$1.5 million and the Authority's estimated gross profit from the development of \$900 000.

□ *RESPONSE provided by Chairman, Urban Land Authority*

The Mews joint venture project was deliberately undertaken by the Authority to meet the objectives of its Act. Some of those objectives will not always provide positive financial returns. In this case, the Authority was fully aware that this joint venture was marginal financially at the best, as is clearly reflected in the resolution adopted by the Authority when it agreed to participate in this project.

The provision of a financial guarantee by the Authority did not alter in any way the course of action it would follow in the event of default by the developer. The Authority accepted from the very earliest consideration of this project that, in the event of default by the developer, its best position would be to take over the project and complete it rather than to rely on the financier to act appropriately from the Authority's viewpoint.

In addition, in the event of default, any outstanding borrowings to be paid to the financier would be only those construction costs drawn-down against the loan. These payments would always be substantiated by the Authority and the financier prior to payment and would always be between 10 per cent and 20 per cent below the value of constructed assets on the land to that point in time.

Accordingly, the Authority does not agree that it took any additional risk. Certainly it did not substantially accept responsibility for the financial risks as financial risks associated with construction and marketing are totally the responsibility of the developer.

**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
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MATTERS RESOLVED OR ACTION COMMENCED

DEPARTMENT OF PLANNING AND DEVELOPMENT

<i>Ministerial Portfolios, May 1993, pp. 227-8.</i>	Due to the Department's failure to adopt a pro-active approach to the provision of property maintenance, through the implementation of a preventative maintenance program, financial benefits in the form of reduced property costs have been foregone.	The Department has increased the emphasis on preventative maintenance of its properties.
<i>Ministerial Portfolios, May 1993, pp. 228-9.</i>	Until such time as the Department determines the physical condition of all its properties, which may take another 7 years, it will not have a sound basis for prioritising the allocation of its maintenance funds nor for determining future funding requirements.	A program to assess the condition of properties was commenced during the second quarter of 1994. It is now envisaged that assessments of all departmental properties will be completed by February 1995. Thereafter, such properties will be inspected over a 5 year period.
<i>Ministerial Portfolios, May 1993, p. 231.</i>	Due, in part, to the non-completion by the Department of property condition reports and infrequent property inspections, the potential to recover maintenance costs from tenants has not been fully realised.	The Department has introduced a process whereby tenancy condition reports are required to be prepared when a tenant first occupies a property and when the property is vacated.
<i>Ministerial Portfolios, May 1993, p. 233.</i>	The exclusion by the Department, of certain vacant properties from its external reporting of rental property vacancy rates, results in incomplete parliamentary and public assessments of the Department's overall performance in minimising vacancies.	Changes to the Department's property management system will facilitate improved disclosure of information on all property vacancies.
<i>Ministerial Portfolios, May 1993, p. 235.</i>	At September 1992, Victoria had the second highest overall public rental property vacancy rate when compared with 3 other Australian States.	The introduction of improved maintenance practices was aimed at reducing vacancy rates.
<i>Ministerial Portfolios, May 1993 pp. 238-9.</i>	At December 1992, the State's net financial contribution to the Home Opportunity Loan Scheme (HOLS) totalled \$28.9 million and a further \$45 million has been set aside to meet any cash flow difficulties of the Scheme.	For further comments, refer to paragraphs 3.10.13 to 3.10.16 of this Report.

**SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued**

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
MATTERS RESOLVED OR ACTION COMMENCED - continued		
<i>Ministerial Portfolios, May 1993, pp. 239-40.</i>	There has been a significant increase in the incidence of loan arrears and repayment arrangements relating to HOLS.	For further comments, refer to paragraphs 3.10.25 to 3.10.27 of this Report.
<i>Ministerial Portfolios, May 1993, p. 240.</i>	Since the inception of HOLS, losses of almost \$3.3 million have been incurred by the Scheme due to borrowers defaulting on loan repayments.	For further comments, refer to paragraphs 3.10.18 to 3.10.20 of this Report.

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Department of Planning and Development	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	29 Sept. 1993	30 Sept. 1993
LOCAL GOVERNMENT				
City of Melbourne Superannuation Fund	30 June 1993	" "	20 Sept. 1993	12 Oct. 1993
MAJOR PROJECTS				
Docklands Authority	30 June 1993	" "	31 Aug. 1993	1 Sept. 1993 (a)
PLANNING				
Architects Registration Board of Victoria	30 June 1993	" "	14 Sept. 1993	21 Sept. 1993
Historic Buildings Council	30 June 1993	" "	21 Sept. 1993	22 Sept. 1993
Loddon-Campaspe Regional Planning Authority	30 Sept. 1993	31 Dec. <i>Annual Reporting Act 1983, s.9.</i>	1 Dec. 1993	8 Dec. 1993
Plumbers, Gasfitters and Drainers Registration Board	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	16 Sept. 1993	17 Sept. 1993
Upper Yarra Valley and Dandenong Ranges Authority	30 Sept. 1993	31 Dec. <i>Annual Reporting Act 1983, s.9.</i>	17 Dec. 1993	20 Dec. 1993
Urban Land Authority	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	24 Sept. 1993	24 Sept. 1993

(a) Qualified audit report issued.

Part 3.11

Premier and Cabinet

3.11.1 The Premier has responsibility for operations within the Premier and Cabinet sector. Details of the specific ministerial responsibilities for public bodies within the Premier and Cabinet sector are listed in Table 3.11A. These public bodies, together with the Department of the Premier and Cabinet, are subject to audit by the Auditor-General.

**TABLE 3.11A
MINISTERIAL RESPONSIBILITY WITHIN THE TREASURY SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Premier	Ombudsman, Office of the Public Service Commissioner, Office of the Victorian Auditor-General's Office Victorian Relief Committee

3.11.2 The audit of the financial statements of entities within the portfolio proved satisfactory.

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Department of the Premier and Cabinet	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	14 Sept. 1993	15 Sept. 1993
PREMIER				
Office of the Ombudsman	30 June 1993	" "	27 Oct. 1993	29 Oct. 1993
Office of the Public Service Commissioner	30 June 1993	" "	24 Sept. 1993	29 Sept. 1993
Victorian Auditor-General's Office (a)	30 June 1993	" "	31 Aug. 1993	1 Sept. 1993
Victorian Relief Committee	30 June 1993	30 Sept. <i>Victorian Relief Committee Act 1958, s.7A.</i>	27 Sept. 1993	27 Sept. 1993

(a) The Victorian Auditor-General's Office was audited by a firm of private auditors.

Part 3.12

Transport

KEY FINDINGS

DEPARTMENT OF TRANSPORT

Non-compliance with regulations

- The Department of Transport incurred expenditure of \$229 500 without proper authority.
Paras 3.12.4 to 3.12.7

Scope for improved tender procedures

- Tendering procedures of the Department and the Public Transport Corporation should be improved to ensure that all potential conflicts of interest are avoided.
Paras 3.12.8 to 3.12.19

Update on provision of school bus services

- No action has been taken to rectify the absence of competitive re-tendering procedures for school bus contracts, a major issue identified 5 years ago by audit.
Paras 3.12.20 to 3.12.36
- The financial ramifications of a lack of action on contracts are substantial, given that the real costs of school bus services have increased by around \$6 million annually since the earlier audit review.
Paras 3.12.25 to 3.12.27

PUBLIC TRANSPORT CORPORATION

Major public transport reform program

- The Public Transport Corporation has embarked upon a major reform program which, if successfully implemented, will lessen the financial burden carried by general taxpayers in funding sizeable transport operating deficits.
Paras 3.12.61 to 3.12.70

Current budget position

- Achievement by the Corporation of higher patronage levels will be a key pre-requisite to sustained improvement in the financial performance of the transport system.
Paras 3.12.71 to 3.12.79

KEY FINDINGS - *continued*

Overview of capital investment decision-making process

- The Corporation's current emphasis on the payback evaluation technique for potential capital projects can adversely impact on the soundness of its capital investment decisions.

Paras 3.12.80 to 3.12.98

Scope for expansion of Board of Management

- Action should be taken to expand the Corporation's board of management, in line with the membership levels authorised by its legislation.

Paras 3.12.99 to 3.12.105

ROADS CORPORATION

Multi-purpose taxi program

- The Multi-Purpose Taxi Program is by far the largest government scheme of its type in Australia with its participation rate over 50 per cent higher than the combined aggregate number for all other States.

Paras 3.12.117 to 3.12.123

- Membership of the Program has increased from 87 600 in 1989-90 to 123 400 in 1992-93 (an increase of 40 per cent) and annual subsidy costs in real terms have risen from \$10.3 million in 1989-90 to \$17.2 million in 1992-93, an increase of 67 per cent.

Paras 3.12.117 to 3.12.123

- The absence of clear objectives and the use of loosely-framed eligibility criteria have been the major reasons for the substantial expansion of the Program's membership numbers and subsidy costs.

Paras 3.12.124 to 3.12.144

- The Program's operational characteristics render it susceptible to fraudulent activity, with a heavy reliance placed on the honesty and integrity of taxi drivers and members.

Paras 3.12.145 to 3.12.158

- Around 9 000 members accounted for more than half of the total number of taxi trips taken during 1992-93, at a total subsidy cost of \$7.9 million, with over 460 members taking more than 400 trips (and 2 members more than 1 100 trips) during the year.

Paras 3.12.152 to 3.12.154

3.12.1 Two Ministers, namely the Minister for Public Transport and the Minister for Roads and Ports, have responsibility for operations within the Transport sector. These Ministers have collective responsibility for the Department of Transport.

3.12.2 Details of the specific ministerial responsibilities for public bodies within the Transport sector are listed in Table 3.12A. These public bodies, together with the Department of Transport, are subject to audit by the Auditor-General.

**TABLE 3.12A
MINISTERIAL RESPONSIBILITIES WITHIN THE TRANSPORT SECTOR**

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Public Transport	MTA Investments Pty Ltd MTA Superannuation Fund Public Transport Corporation
Roads and Ports	Marine Board of Victoria Port of Geelong Authority Port of Geelong Authority Superannuation fund Port of Melbourne Authority Port of Portland Authority Roads Corporation

3.12.3 Comment on matters of significance arising from the audit of certain of the above entities is provided below.

DEPARTMENT OF TRANSPORT

NON-COMPLIANCE WITH REGULATIONS

3.12.4 Under the Treasury Regulations which operated up to 30 June 1993 and were replaced on that date by the Audit (Supply Management) Regulations 1993, departments were required to obtain Tender Board approval before entering into contracts for the acquisition of stores, services or works with a value in excess of \$50 000 (the replacement regulations increased this limit to \$100 000).

3.12.5 An examination by audit of contracts entered into by the Department of Transport disclosed that in the following 2 cases, involving total outlays of \$229 500, the Department failed to obtain Tender Board approval in accordance with the applicable Treasury Regulations:

- In November 1992, the Department engaged a firm of personnel management consultants to assist it in the search for a Chief Executive Officer for the Public Transport Corporation. The final cost of this consultancy was \$82 700; and
- In January 1993, the Department entered into a contract with an advertising company to conduct an advertising campaign aimed at creating public awareness of the matters contained in the Government's January 1993 major reform statement on public transport, at a cost of \$146 800.

3.12.6 With regard to the November 1992 engagement, audit found that the original tender documentation held at the Department specified a tender cost of \$83 990. The relevant departmental file indicated that, after receiving tender submissions, the Department requested 3 of the 5 respective tenderers to resubmit tenders at a lower cost. Subsequently, the successful tenderer was awarded a contract for \$74 240, which included consultancy fees of \$39 000 and estimated additional costs (e.g. "out of pocket" expenses) of \$35 240.

3.12.7 As a consequence of the Department's failure in these 2 cases to obtain Tender Board approval, expenditure totalling \$229 500 was incurred without proper authority.

□ *RESPONSE provided by Secretary, Department of Transport*

In respect of the first case, while Tender Board approval had not been obtained several written tenders were nevertheless received and the best overall tender was accepted. Again, no additional costs were incurred as a result of not obtaining formal Tender Board approval. Recent changes to Audit Regulations do not require Tender Board approval for such contracts below \$100 000.

In respect of the second case, while tenders were not called, the cost of \$146 800 was contracted at rates which the State Tender Board has approved. In this respect, no additional costs were incurred as a result of not tendering the work.

SCOPE FOR IMPROVED TENDER PROCEDURES

3.12.8 In January 1993, the Minister announced that, in line with the major transport reform statement, tenders would be called for the contracting-out of all 6 groups of Met bus services operated by the Corporation. However, the Corporation, which up until that time had been the sole provider of Met bus services, was also invited to submit a tender to retain its position as operator of the services. Because the Corporation would be participating as a tenderer, arrangements were made for the Department of Transport to act on its behalf in the evaluation of tenders and submission of recommendations to the Minister for the awarding of contracts.

3.12.9 Prior to the ministerial announcement, the Department, acting on behalf of the Corporation, engaged an external industry consultant for the primary purpose of preparing the necessary documentation to enable the Department to call for expressions of interest for the operation of bus services. The consultancy also involved preparation of criteria for evaluation of the expressions of interest and provision of advice to the Department's tender evaluation panel in response to any questions of a technical nature. The consultancy services were provided over the period December 1992 to June 1993 and involved a cost of \$55 000, which was met by the Corporation. The Department advised audit that the majority of tasks assigned to the consultant had been completed for all intents and purposes prior to the calling of tenders for Met bus services.

3.12.10 Tenders were called for in April 1993 and closed on 28 May 1993 with 12 tender submissions subsequently received by the Department. To ensure an independent evaluation of these tenders, the Department invited 3 chartered accounting firms to submit proposals to audit the tender process and participate on the tender evaluation panel. In April 1993, a panel was established consisting of 3 departmental officers and representatives from the Department of the Treasury and the selected chartered accounting firm (the firm's costs in the evaluation process, which amounted to \$221 000, were also met by the Corporation). **The Secretary of Transport advised audit that the Department later determined that the selected chartered accounting firm would undertake the tender evaluation process without the assistance of the panel.**

3.12.11 The chartered accounting firm, subsequently recommended that, on the basis of the established evaluation criteria, the Department proceed to negotiate with one tenderer, a NSW-based company, the National Bus Company, in respect of the 5 groups of bus services for which it had tendered. The firm also recommended that the Department negotiate a contract with this company to operate the remaining services for which it had not tendered.

3.12.12 In addition to its prime recommendation, the firm indicated that the Department may wish to consider the advantages of not awarding contracts for all groups of bus services to a single operator. Such advantages were cited by the firm as including "... a perception of greater fairness, a better position in the case of operator failure and benefits of yardstick competition". In this regard, the firm considered a feasible alternative recommendation by the Department to the Minister would be to negotiate with:

- the National Bus Company in respect of that company's minimum requirement of undertaking the 3 major groups of Met bus services included in its tender; and
- the Corporation for continued operation of the 3 remaining groups of services.

3.12.13 The firm's view was that this recommendation would be well supported having regard to the wider public transport policy issues involved.

3.12.14 In August 1993, the Minister announced that the National Bus Company had been allocated 80 per cent of Met bus services (the 3 major groups of services comprising a total of 51 bus routes) with the remaining 20 per cent (the 3 smaller groups of services comprising a total of 13 bus routes) awarded to the Corporation. The contract awarded to the National Bus Company related to the provision of bus services along the allotted routes for a period of 7 years with an estimated overall value of \$130 million.

3.12.15 Subsequent to the awarding of the contract to the National Bus Company, information was released in the public arena which indicated that the external industry consultant engaged by the Department in December 1992 had been involved in the past in close business relationships with the principals of the company. In September 1993, the consultant provided written information to the Department on the matters raised in the public arena which confirmed, *inter alia*, past business relationships with the principals of the company.

3.12.16 Files held by the Department dealing with the engagement of the industry consultant, which were examined by audit, contained no information to indicate that either the Department or the Corporation were aware, or **sought to become aware**, of the prior business links of the engaged consultant with the successful tenderer. In this respect, the documented policies of both the Corporation and the Department covering the purchase of goods and services did not require prospective consultants to disclose past business associations or interests in planned areas of consultancy activity.

3.12.17 Although the departmental files did not indicate whether the Department or the Corporation were aware of the prior business links of the engaged consultant with the successful tenderer, the Chairman of the Corporation, who was the acting Secretary of the Department at the time of the consultant's appointment, advised audit that:

"The Consultant was selected for this role after assessing a number of possibilities and consulting with a number of sources including the NSW Department of Transport and the Bus Proprietors Association. He was chosen because he was the only available person with direct hands-on experience of both government and private bus operations and with experience in consulting to government and private bus operators in Australia and overseas. The issue at stake with the privatisation of the Corporation's bus operations and the longer term revision of the existing private bus contract in Victoria, is potential savings to the Victorian taxpayer of several tens of millions of dollars per annum, and it was believed, essential to have the best possible experience applied to the problem.

"The consultant in his previous work with the bus industry had frequent association with and done work for both private and government bus operators. At the time he was employed by the Corporation, however, he had no commitment with others which we believed was in any way in conflict with the work we asked him to do. This was established in discussion with the consultant before he undertook any work for us. At no time during his work with the Department and the Corporation was there any suggestion to my knowledge that there might have been a conflict of interest.

"In terms of the evaluation of the tenders we received, it was a conscious policy of both the Corporation and the Department that he should not have access to the tenders or any part of them, as clearly these were privileged business documents strictly between the tenderers and the Victorian Government. During the independent evaluation of the tenders by the chartered accounting firm he was available to provide technical advice only direct to them as they determined simply to ensure that they were clear about the intention of the specifications. In the event this resulted in one short session with him to clarify the service and fare model on which the tender was based.

"It needs to be understood that the consultant was engaged to prepare service and fare models against which tender specifications could be designed. The work he did was a prelude to the tender process. At that time it was not possible to gauge who tenderers might be if and when tenders were actually called. When tenders were received he was not involved in their evaluation and did not have access to them in any shape or form."

3.12.18 Having regard to the significant involvement of the industry consultant in the processes leading to evaluation of tenders and the existence of previous business relationships with the appointed tenderer, audit considers that all prospective consultants should be required to disclose in writing past business relationships or interests in areas of planned consultancy activity. The Corporation and the Department should move to incorporate this provision in their documented tender procedures.

3.12.19 While audit does not question, in any way, the probity of the consultant, there remains the issue of an appearance of a conflict of interest. Audit considers that action should be taken to ensure that all potential conflicts of interest are avoided and that the key principles of independence, equity and open competition are not only applied but are seen to be applied in all tender situations.

UPDATE ON PROVISION OF SCHOOL BUS SERVICES

3.12.20 The *Auditor-General's Report on Ministerial Portfolios, May 1989*, included the results of a wide-ranging audit review of the provision of transportation services by bus contractors to primary and post-primary education students in Victoria.

3.12.21 The 1989 review found that the use of open-ended contracts, with no specified contract periods, and the absence of conventional re-tendering arrangements were key deficiencies which precluded attainment of maximum levels of cost-effectiveness in the provision of school bus services. In addition, the review identified weaknesses in other aspects of the management framework including significant over-compensation to contractors for depreciation and a need for greater assurance as to the accuracy of recorded distances for bus routes, which, if remedied, could achieve estimated annual savings of \$7 million. The review also raised some important safety issues involving overloading of buses, concerns as to the mechanical condition of buses and the limited availability of communication facilities for use in emergency situations.

3.12.22 At the time of the 1989 audit review, school bus services were under the control of the former Ministry of Education, a predecessor body of the Directorate of School Education (DSE). In January 1990, responsibility for administration of the services was transferred to the Department of Transport which delegated this responsibility to the Public Transport Corporation. The responsibility for policy matters dealing with travel eligibility and safety issues remained with the DSE.

3.12.23 The provision of free school transport was introduced in Victoria in 1944 for the specific purpose of enabling secondary students in isolated country areas to attend State schools without having to reside away from home. At that time, 136 bus services provided transportation for approximately 4 600 students. The availability of transport services was later extended to State primary school students and, in certain circumstances, to students attending non-government schools. Currently, 1 709 bus services are required to transport approximately 73 000 students. In 1992-93, contracted outlays for school bus services totalled \$76 million, which in real terms was about \$6 million higher than the annual outlays (in 1987-88) around the time of the previous audit review.

3.12.24 During the year, audit assessed the extent to which the issues raised in the earlier review had been addressed by the Corporation (on behalf of the Department of Transport) and, where applicable, by DSE.

OVERALL CONCLUSION

3.12.25 The re-visit by audit, after 5 years, to this major area of contractual activity with the private sector has found that the principal impediment to attainment of maximum levels of efficiency, namely the use of open-ended contracts, under which contracts with bus operators continue indefinitely without periodic re-tendering, has not been decisively addressed.

3.12.26 In addition, no action has been taken to remedy over-compensation to bus contractors through continuation of depreciation allowances in contract payments beyond the assessed depreciable lives of buses.

OVERALL CONCLUSION - *continued*

3.12.27 The financial ramifications of a lack of action on the above issues are substantial, given that the real costs of provision of school bus services have increased by around \$6 million annually since the earlier audit review. The efficiency gains which would be derived from introduction of fixed-term contracts under conventional re-tendering conditions cannot be accurately measured but are likely to be significant. The failure to remedy over-compensation of depreciation allowances to bus contractors has meant that, since the 1989 audit review, potential annual savings estimated at that time to be around \$2.5 million have not been pursued.

3.12.28 From a more positive viewpoint, the Department of Transport (via the Public Transport Corporation) has substantially rationalised bus routes and terminated 119 services, identified as surplus to requirements, with annual savings of \$4 million. Also, the DSE and the Corporation have made some clear progress on the important safety issues addressed in the earlier audit review, particularly in respect of passenger overloadings.

3.12.29 The Department has recently engaged an external consultant to undertake an extensive review of school bus services encompassing both contractual and operational matters. Audit has been advised by the Department that the key issues of open-ended contracts and compensation to contractors for depreciation will be carefully examined during this consultancy.

Impact of open-ended bus contracts

3.12.30 In the 1989 review, audit examined the open-ended nature of bus contractual arrangements which, because of the absence of fixed contract periods, **meant that contracts remained in force as long as the need for the student transportation existed and the contractor was delivering a satisfactory service.**

3.12.31 It was also revealed that conventional re-tendering procedures were only followed for new services and the competitive elements of this limited approach were further restricted by adoption of the "last off first on" principle, under which previously displaced bus proprietors were given first option for contracts involving a new service within their region. **This practice effectively precluded prospective contractors from entering the school bus service market.**

3.12.32 Because fixed service terms and periodic re-tendering procedures are generally viewed as fundamental to establishing a competitive environment to ensure effective cost control mechanisms for large numbers of contracts, the audit review recommended that these key features be introduced without delay for all bus service contracts. The review also recommended, as an interim action, that discussions be held with the Bus Proprietors Association (the representative body for bus contractors) aimed at removal of the anti-competitive principle from contract procedures for new services.

3.12.33 The management response at the time from the former Ministry of Education on the above audit recommendations agreed that "... *fixed-term contracts and periodic competitive re-tendering were fundamental to assuring effective resource management*". It indicated both issues raised by audit would be examined as part of a review of bus contracts to be undertaken during 1989-90.

3.12.34 The current review has found that action was subsequently initiated by the Corporation in 1991 to reach agreement with the Bus Proprietors Association on the removal of the "last off first on" principle from procedures for new bus contracts. Since 1991-92, all new contracts have been subject to competitive tendering arrangements.

3.12.35 On the major issue of open-ended contracts, it was most disappointing to find that, 5 years after the earlier review, no decisive action had been taken either by the former Ministry of Education (despite the fact that it had acknowledged that such measures were "fundamental to assuring effective resource management") or, in later years, by the Department.

3.12.36 Until the question of fixed contract tenure is effectively addressed, the inefficiencies inherent in the existing arrangements, which cannot be accurately estimated but are likely to be extensive, will remain.

Over-compensation of depreciation to bus proprietors

3.12.37 The calculation of payments to bus proprietors under school bus contracts is based on a formula which comprises several cost elements including a specified allowance for depreciation.

3.12.38 The cost allowance in respect of the depreciation return agreed between the Corporation and contractors is based on 80 per cent of the actual cost of the bus vehicle or list price, whichever is the lower. A depreciation rate of between 12 per cent and 15 per cent is applied depending upon the length of the bus route.

3.12.39 The 1989 review found that the depreciation allowance to contractors continued to be applied irrespective of whether the capital cost of a vehicle had been fully recouped by or reimbursed to the contractor, that is, contract payments continued to include the depreciation allowance beyond the assessed depreciable life of a bus.

3.12.40 At the time, audit estimated that the annual amount of over-compensation to proprietors for depreciation allowed on buses beyond their depreciable lives was **around \$2.5 million annually**. Audit recommended that action be taken to align the depreciation return to proprietors with the assessed useful lives of buses so that over-compensation could be progressively removed.

3.12.41 In line with the position outlined above for open-ended contracts, the current audit examination found that **no action had been taken over the last 5 years to remedy over-compensation of depreciable allowances to bus proprietors**.

3.12.42 The absence of any remedial action on this matter has meant that, since the 1989 audit review, potential annual savings estimated at that time to be around \$2.5 million have not been pursued.

Rationalisation of bus services

3.12.43 The 1989 audit review commented on the importance of periodic reviews of kilometre distances of all school bus routes so that payments to bus proprietors are always based on current and accurate distances. The review compared, for a sample of bus routes, audit field measurements with contract records and found that **if the differences in distances identified in the sample were representative of all routes, potential annual savings of \$4 million could be achieved.** The review also identified that contract payments of around \$3.9 million were made each year in respect of particular routes, involving around 7 per cent of buses (over 120 vehicles), where less than 65 per cent of seating capacity was utilised. Audit emphasised at the time the need for regular assessments of the cost implications of under-utilised carrying capacity and for the rationalisation of those bus routes which consistently exhibit low passenger numbers.

3.12.44 In 1990, the Corporation commenced a rationalisation process aimed at identifying and removing surplus bus services. **The Corporation has subsequently identified 119 school bus services as surplus to requirements. These services, which had involved annual payments totalling \$4 million have been terminated, either through direct closure or consolidation with neighbouring routes.**

3.12.45 As part of the above initiative, all bus routes were re-measured by the Corporation and, where appropriate, bus proprietors' contracts were amended. Since the review, the Corporation has established procedures to re-measure bus routes each time a service is changed and to incorporate revised distances into the relevant bus contracts.

3.12.46 The Corporation has estimated that additional annual costs of \$1.2 million will be incurred for school bus services following the closure of a number of schools under the Government's Quality Provision program.

Safety issues

3.12.47 The scope of the 1989 audit review included consideration of important safety matters directly relevant to school bus services.

Overloading of buses

3.12.48 In addition to identifying under-utilised carrying capacity (as previously mentioned), the earlier review found that 118 buses carried student numbers in excess of specified carrying capacities. This overloading of students had occurred because school principals and school bus co-ordinators within schools, who are responsible for the verification and endorsement of conveyance details prepared by bus contractors, had not identified a need for central corrective action on the matter. The review stressed that given such circumstances, which could be construed as official endorsement of student carrying numbers, there was a high risk exposure to liability for damages, should a bus with excess passengers be involved in a serious accident.

3.12.49 In late 1989 (subsequent to the earlier review), the former Ministry of Education produced an updated school bus guidelines manual for school principals, which clearly documented passenger loading guidelines and procedures to be followed where overloading occurred. Since the transfer of administrative responsibility to the Corporation, there has been regular liaison between the Corporation, school principals and bus co-ordinators, and DSE regional offices to ensure more effective control over the number of students travelling on each bus route. In addition, annual loading surveys have been conducted on all bus routes, under which student passenger numbers are measured against the maximum carrying capacity of buses.

3.12.50 Since 1990, the Corporation has introduced 45 additional buses on existing routes involving annual payments of \$1.4 million to overcome passenger overloading problems.

3.12.51 The issue of safety on school buses was addressed by a School Bus Transport Review Working Party established by the DSE in January 1993. Following consideration of safety options submitted by the Working Party, **the Minister for Education announced in November 1993 that the Government would allocate funds over a 3 year period for additional bus services on bus routes which traverse areas with higher speed limits (in excess of 80 kilometres per hour) to eliminate the problem of standing passengers on those routes by 1996.** To date, no expenditure has been incurred for this purpose.

Mechanical and physical condition of school buses

3.12.52 An audit analysis undertaken during the 1989 review revealed that over 500 buses (or around 30 per cent of all vehicles used to transport students at the time) were over 20 years old. The review also disclosed that annual inspections of school buses by the Roads Corporation (Vic Roads) resulted in a high detection rate of faults with, on average, 70 to 80 per cent of buses requiring at least a second inspection. Also, the former Ministry of Education did not have in place procedures under which information on the results of the inspections of school buses could be systematically captured and monitored

3.12.53 The combination of the above 3 factors created a potential liability in the event of accidents involving bus vehicles in need of repair.

3.12.54 Since it was assigned administrative responsibility for school bus services in 1990, the Corporation has directed particular emphasis to monitoring the safety condition of buses. In this regard, the results of annual vehicle inspections by Vic Roads have been recorded and analysed, with contractors directed to replace buses where serious safety problems were identified. Up until 30 June 1993, 265 replacements of buses for safety reasons have occurred. Also, the rate of replacements based on the age of buses has proceeded at a consistent rate and, at the date of preparation of this Report, **the number of buses over 20 years old had fallen to 235 (or about 13 per cent of the total number of buses).**

Limited availability of communication facilities

3.12.55 The majority of school bus routes are located in rural areas of the State. Many of the routes extend through areas which are at times prone to seasonal hazards such as bush fires and flooding.

3.12.56 The 1989 review drew attention to the absence of direct communication facilities, e.g. 2-way radio communication, between schools, bus co-ordinators and bus drivers. Audit concluded at the time that the availability of 2-way radio communication for all school bus routes would enhance the overall safety of school bus services. In reaching this conclusion, audit recognised the cost implications of introduction of direct communication facilities across the entire school bus system. However, it was felt that the benefits of an enhanced safety environment for school buses warranted early consideration of available options.

3.12.57 The recent audit inquiries have revealed that, until 1993, no action had been taken to introduce radio communication facilities between schools, bus co-ordinators and bus drivers for all bus routes.

3.12.58 The 1993 School Bus Transport Review Working Party (referred to in an earlier paragraph) considered the feasibility of introduction of 2-way radio communications to the school bus system and recommended in its discussion paper to the Minister for Education that "... *consideration be given to provision of 2-way facilities, particularly in remote areas and areas subject to fire and flood*". The Minister subsequently announced that "... *discussions are taking place with the Corporation to request the inclusion into contracts of a requirement that school contract bus services install 2-way radios and flashing lights as a condition of contract renewal*".

Recent initiative

3.12.59 The Department has recently engaged an external consultant to undertake a wide review of school bus services encompassing both contractual and operational matters. The terms of reference for the review are:

"Within the current policy guidelines for the provision of school bus services as determined by the Directorate of School Education the review should examine and advise on:

- *can the existing contracting arrangements be improved to ensure that the government obtains:*
 - *best value for money from its subsidy payments;*
 - *greatest flexibility in the provision of services within the current policy guidelines;*
 - *best possible bus fleets to meet service requirements; and*
- *can the existing operations and bus routes be improved in order to eliminate inefficiencies, and to most effectively match services with demands, whilst still adhering to current policy guidelines".*

3.12.60 Audit was advised by the Department that the 2 important matters which remain unaddressed some 5 years after the 1989 audit review, namely, use of open-ended contracts and over-compensation to bus proprietors for depreciation, will be subject to specific examination during this consultancy.

RESPONSE provided by Secretary, Department of Transport

A consultant appointed by the Department of Transport is currently examining the contracting arrangements for these services and most of the observations made by the Auditor-General's Office are included in this review.

The Department does not agree with audit's comments that the \$2.5 million over-compensation of depreciation allowances have not been pursued. While audit comments that the depreciation allowances are being paid longer than the economic life of buses, it has not acknowledged, however, factors such as sick leave allowances, administrative costs, garaging and depot costs are being under-compensated in the contracts and should be considered as compensating factors.

It is pleasing to note that the Auditor-General has reported that, overall, some \$4 million savings a year has been achieved from the operation of these services through initiatives such as rationalisation of routes and closer tailoring of services to meet student requirements.

PUBLIC TRANSPORT CORPORATION

MAJOR PUBLIC TRANSPORT REFORM PROGRAM

3.12.61 In January 1993, the Government announced a major reform package for the Public Transport Corporation which focused on the long-term viability of public transport in Victoria and transformation of the public transport system into a service that meets the needs of its customers.

3.12.62 The key strategic goal underpinning the reform package was to reduce the Corporation's annual operating cash deficit, which is funded by general taxpayers via the Consolidated Fund, by \$245 million over the period to December 1995. A staff downsizing target of 8 500 employees over the reform period was also established for the Corporation.

3.12.63 The Government's reform statement indicated that the targeted savings of \$245 million would be achieved by implementation of a range of resource management initiatives extending across the whole framework of the public transport system. Since the statement, many major decisions have been taken in line with the new reform direction with quite substantive progress achieved in some significant areas of the Corporation's operations. Also, a new management structure for the Corporation was introduced in November 1993 to complement the reform process.

3.12.64 From an audit viewpoint, it is appropriate to recognise the significance of the announced reforms and the challenges facing the Corporation in terms of progressive achievement of the various targets. With this point in mind, audit has summarised in Table 3.12B the areas comprising the reform program and the implementation position at date of preparation of this Report.

**TABLE 3.12B
PUBLIC TRANSPORT REFORM PROGRAM**

<i>Reform area</i>	<i>Reform action</i>	<i>Current status advised by the Corporation</i>
Workshops	Closure of several depots, workshops and commercial functions, rationalisation of maintenance activities between workshops and the re-organisation of the Corporation's maintenance structure (initial targeted savings \$95.2 million).	At 31 December 1993, 3 country depots and 3 locomotive depots had been closed. Other closures included furniture manufacturing, Jolimont workshop, and Newport foundry. Manufacturing previously undertaken at Preston Tram Workshop has been transferred to Bendigo and Ballarat Workshops. Staff numbers at workshops were reduced by 1 224 in 1992-93 with estimated yearly savings of \$44.5 million. In the half year to 31 December 1993, a further 417 staff have been terminated, with additional annual savings of \$14.5 million.
Automated ticketing and driver-only operations	Introduction of automated ticketing and the conversion of all trains and trams to driver-only operation (initial targeted savings \$47.5 million).	The Corporation has selected a tender for the development and installation of automated ticketing. Contractual negotiations are under way, including the development of detailed user and hardware specifications. Also, a contract has recently been awarded to convert Melbourne's trams to driver-only operation. As an interim measure, limited driver-only operations have been introduced on a number of train and tram services.

TABLE 3.12B
PUBLIC TRANSPORT REFORM PROGRAM - continued

<i>Reform area</i>	<i>Reform action</i>	<i>Current status advised by the Corporation</i>
Infrastructure	Contracting-out of general building maintenance, tendering of construction activities and improvement in labour force efficiencies (initial targeted savings \$18 million).	Changes to infrastructure services include the contracting-out of general building maintenance and construction activities, and improving labour force efficiencies. At 31 December 1993, 55 contracts for work previously performed in-house have been let at a total annual value of \$1.3 million. Tenders have been called for a further 9 contracts estimated at \$400 000 a year.
Freight	Contracting-out of metropolitan road freight operations and line haulage at country locations (initial targeted savings \$14.3 million).	Road operations of metropolitan freight distribution and the line haulage of freight to country locations have been contracted.
Fare increase and rental adjustment	Increase of fares by 10 per cent and a review of rents charged by the Corporation's lease property management group (initial targeted savings \$14 million).	An average fare increase of 10 per cent took effect from 1 January 1993. In addition, on 9 January 1994, the Corporation further increased fares by an average of 4.5 per cent.
Corporate overhead staff	Reduction of total Corporate overhead staff by 450 (initial targeted savings \$12.4 million).	In 1992-93, 179 overhead staff ceased employment with the Corporation. The Corporation anticipates that during 1993-94 and 1994-95 a further 271 staff will be terminated.
Met bus services	Contracting-out of all metropolitan bus services (initial targeted savings \$10 million).	At January 1994, over 80 per cent of the metropolitan bus routes run by the Corporation have been contracted out to the National Bus Company. These routes include Ringwood, Templestowe and Clifton Hill. The Corporation will continue to run the remaining bus routes on a commercial basis in accordance with its tender.
Country rail services	Contracting-out of 9 passenger rail services (initial targeted savings \$6 million).	At 31 December 1993, 5 lines were privately-operated, 2 lines were partially operated by the private sector (V/Line trains connecting with privately-operated coaches) and 2 services remained in the control of the Corporation.
Metropolitan rail services	Replacement of several rail services with buses (initial targeted savings \$5.4 million).	Due to an agreement with unions, the Corporation has moved away from the original plan to replace rail services with buses during off-peak times on the Newport to Williamstown, North Melbourne to Upfield and Camberwell to Alamein lines. Driver-only trains have been implemented on these lines. The proposed closure of the Upfield line has been deferred pending completion of an environmental effect statement for the Western By pass. A final decision is unlikely before March 1994.

TABLE 3.12B
PUBLIC TRANSPORT REFORM PROGRAM - continued

<i>Reform area</i>	<i>Reform action</i>	<i>Current status advised by the Corporation</i>
Bus services in lieu of trains and trams	Replacement of 8 rail and 7 tram services with buses after 8 pm (initial targeted savings \$4.5 million).	Due to an agreement with unions, this reform has been cancelled.
Private bus contracts	Initiatives include the withdrawal of subsidies for airport and football buses, reduction of bus services and a review of vehicle replacement (initial targeted savings \$4 million).	Negotiations with the Bus Proprietor's Association have achieved alternative savings of \$400 000 allowing for the replacement of 50 buses. All changes proposed under the reform package have since been implemented, except for 1 initiative which will be introduced mid-July 1994.
Inventory reduction	To upgrade materials policies and procedures and reduce inventory levels (initial targeted savings \$3.8 million).	The Corporation has altered its material acquisition policies and is reducing the level of investment in inventories.
Trading and catering	Contracting out of all catering and retail operations at Spencer St, Flinders St, Geelong and Bendigo Stations as well as staff canteens (initial targeted savings \$3.5 million).	The Corporation has decided that the Spencer St Station catering and retail operations will remain in-house. Geelong and Bendigo stations' retail operations have been contracted out. Majority of retail outlets at Flinders St Station have been leased and several staff canteens have been contracted out.
Contract cleaning	Contracting-out of all train station, tram depot, toilet, shelters and administration building cleaning services (initial targeted savings \$2.5 million).	Cleaning contracts for stations, train and tram administration buildings, depots, tram route toilets and shelters have been awarded.
Other reforms	These initiatives include the cessation of a dedicated city loop train, commuter flow on and roster changes in metropolitan trains (initial targeted savings \$3.9 million).	These initiatives have since been implemented.

3.12.65 Audit has stressed to the Corporation the importance of having in place effective data gathering and monitoring procedures which enable structured assessments to be made of progress achieved in the implementation of targeted savings. This approach is necessary not only for sound decision-making during the course of the reform program but also to ensure that all costs associated with new management strategies are accurately recorded and capable of comparison with costs previously incurred under replaced strategies. Substantiation by the Corporation of actual cost savings ultimately achieved during the reform period is dependent upon this latter point.

3.12.66 Two of the key elements of the Corporation's reform package have been the subject of comment in recent years in Reports of the Auditor-General to the Parliament.

3.12.67 The *Report on Ministerial Portfolios, May 1992* outlined the results of a major audit review of the management of the Corporation's **workshops**. That review identified that substantial savings could be generated through more efficient management of workshop resources and greater productivity generally. Although virtually all key conclusions by audit were strongly disputed in responses provided by the Department of Transport, which were incorporated into the Report, it is particularly pleasing to find that the Corporation has subsequently identified annual achievable savings of around \$95 million in the area. This outcome clearly supports the earlier audit comments conveyed to the Parliament.

3.12.68 An audit analysis of the provision of **MET bus services**, included in the *Report of Ministerial Portfolios, May 1990* found that, on a cost per kilometre basis, the annual operating costs of MET bus services were about \$12.8 million higher than the contracted private bus operations. The audit review identified a need for the Corporation to upgrade its management processes relating to the costs of MET bus services so that it could reach informed decisions on the optimum mix of services between MET and private operators. The reform action now in place under which a substantial portion of MET bus services have been contracted-out to a private operator, with annual targeted savings of \$10 million, complements the earlier audit conclusion to the Parliament on the subject.

3.12.69 Finally, it is relevant for audit to point out that the Corporation has not viewed the January 1993 reform package as a static management concept and the only factor influencing the direction of resource management strategies. It is continuing to pursue reforms additional to those identified in the policy statement with the aim of generating further efficiency gains. A recent example of this position was the announcement by the Minister during March 1994 that private developers had been engaged to provide shops, car parks and other facilities at railway stations in Melbourne and regional centres. The Corporation anticipates substantial levels of rental income will be generated from these ventures.

3.12.70 In summary, the Corporation, to its credit, has embarked upon a major reform program. If successfully implemented, the program will bring about substantial resource savings and lessen the financial burden presently carried by general taxpayers in funding sizeable transport operating deficits.

□ *RESPONSE provided by Secretary, Department of Transport*

As acknowledged by audit, the Government has successfully set in place a program of reform across the whole public transport system to reduce the enormous annual operating subsidy which it acquired from the previous Government, while at the same time providing an efficient, clean and safe service.

Many initiatives and strategies relating to contracting out services, e.g. Met bus services, internal audit, efficiency improvements e.g. workshops, automated ticketing and driver-only operations, and changes to passenger and freight services and corporate administration have been introduced dramatically changing and improving the effectiveness and efficiency of the system.

CURRENT BUDGET POSITION

3.12.71 The Government's January 1993 reform program was specifically designed to place initial emphasis on lowering the long-term costs of the public transport system. A later focus of the program was to be on improving service reliability and satisfying customer needs.

3.12.72 By 30 June 1993, the Corporation had exceeded its staff downsizing target for the year (3 900) by 200 employees, i.e. staff numbers fell in total by 4 100 over 1992-93. This position meant that in terms of salaries, wages and related outlays, the Corporation was well placed to work to a substantially-reduced operating cash deficit target for 1993-94, compared with the previous year. It followed that **the Corporation's recurrent contribution from the Consolidated Fund to cover its deficit for 1993-94 was set by the Government at \$401 million, or \$87 million lower than the actual figure in 1992-93.**

3.12.73 At 5 March 1994, the Corporation's cash position was \$20.3 million better than its budgeted cash position to that date. Audit analysis indicated that this favourable variance from budget was mainly due to higher than expected freight revenue and savings in rail vehicle maintenance costs, electricity and other non-labour expenditure.

3.12.74 It became clear during this analysis that the most significant factor likely to impact on achievement by the Corporation of its targeted lower operating cash deficit by December 1995 (as discussed in the earlier paragraphs), will be the organisation's ability to maintain satisfactory levels of customer patronage. **In other words, the passenger revenue side of the Corporation's operations is going to be a key element influencing the Corporation's financial performance over its reform period.**

3.12.75 In recent years actual patronage levels of the Corporation have been declining while revenue has remained relatively static. Table 3.12C compares the Corporation's actual patronage levels for Met services and related passenger revenue for the period 1991-92 to March 1994 in the current year.

TABLE 3.12C
ACTUAL PATRONAGE AND REVENUE LEVELS,
1991-92 TO MARCH 1994
(millions)

	1991-92	1992-93	To March 1994
Patronage (nos.)	314.5	298.5	192.7
Revenue	\$310.7	\$314.6	\$211.9

3.12.76 As shown in the above table, actual patronage levels to March 1994 have declined significantly since 1991-92. While an average increase in public transport fares of 4.5 per cent introduced from 9 January 1994 was aimed at increasing passenger revenue, its impact will be limited if passenger numbers continue to fall.

3.12.77 Against the above background, the Government has recently implemented the second phase of its January 1993 reform program in terms of aiming to enhance service reliability and focusing on customer needs. In a March 1994 announcement, the Minister stated that as part of the second stage of the reform package:

- improved punctuality targets have been set for tram and train divisions;
- all stations would be repainted over 5 years;
- over 300 roving customer service jobs would be created; and
- improved timetable information would be available to passengers for trains, trams and buses.

3.12.78 The Minister also stated that:

"... public transport would only win back and attract new customers when the Corporation delivered a service that its customers could rely on and was on time. The reform package sets high standards. The reforms will need 100 per cent commitment from everyone in the Corporation ranging from drivers to senior management. Anyone who is not prepared to put the customer first will have no future role in the Corporation".

3.12.79 The Corporation now has the major challenge of building on its improved cost position to ensure that a reliable and responsive public transport service is provided to customers. Higher passenger levels will be the key prerequisite to sustained improvement in the system's cost-effectiveness.

□ RESPONSE provided by Secretary, Department of Transport

Audit is incorrect in claiming "... that the passenger revenue side of the Corporation is going to be the key element in influencing the Corporation's financial performance over the reform program".

As detailed in audit's review of the initiatives, only \$14 million of the reform program (\$245 million) relies on revenue gains (these were achieved through small fare increases); the remainder of the reform program is based on cost reduction. The key imperatives are the continued reduction of staffing levels and introduction of new technology which is progressing well as acknowledged by audit. The only revenue requirement is that it should not fall below the 1991-92 level. In fact revenue has been slightly higher than this level and is therefore not an issue in achieving the reform program.

Notwithstanding the achievement of financial targets, it is the objective of Transport to stop the decline in patronage by providing a quality service to the public.

OVERVIEW OF CAPITAL INVESTMENT DECISION-MAKING PROCESS

3.12.80 In fulfilling its function to efficiently manage and provide a safe and reliable public transport system in Victoria, the Public Transport Corporation needs to invest substantial levels of funds in capital projects directed at the upgrading and expansion of infrastructure and other fixed assets. **Over the last 5 years, aggregate capital expenditure of the Corporation has been in excess of \$1 billion.** At 30 June 1993, the Corporation's fixed asset holdings, excluding land and leased assets, were valued at approximately \$2.5 billion and included infrastructure assets directly related to the public transport system such as track and signals (\$1 billion), buildings (\$507 million), operating vehicles (\$374 million), and plant and equipment (\$365 million).

3.12.81 Capital investment decisions of the Corporation have a significant impact on the overall effectiveness of the public transport system and, in turn, on the long-term financial viability of the Corporation. This impact is particularly relevant to the Corporation's current strategic goals of upgrading the quality of service delivery across the transport system and more effectively meeting customers' needs.

Establishment of Corporation Investment Panel

3.12.82 In August 1993, the Corporation took an important step to strengthen its strategic management framework in relation to capital investments with the establishment of a *Corporation Investment Panel*. The role of this Panel is:

"... To ensure that the Corporation's investment in infrastructure, rolling stock and related programs returns maximum benefits for the funds employed and is directed to delivering the needs of users, the Corporation's overall business objectives, strategies and Government priorities".

3.12.83 With regard to the planning of projects, the Panel assesses all capital investment proposals submitted by individual business units and approves the Corporation's annual capital budget for consideration by the Government as part of the State's budgetary process. Business units are required to follow a structured approach in development of their submissions to the Panel commencing at the concept level and extending to a project's justification in terms of:

- potential financial or economic benefit;
- scope for enhancing the safety of the public transport system; and
- opportunities to improve the quality and reliability of service delivery to customers.

3.12.84 Following this process, the Panel identifies expenditure proposals which can proceed to an appraisal stage where more detailed planning and evaluation are performed by the responsible business units.

3.12.85 **The formation of the Panel is a positive initiative by the Corporation and should help to ensure that its important decisions on capital investments are soundly based and systematically linked to areas of greatest priority.**

Appraisal of potential projects

Excessive emphasis on payback method

3.12.86 Under the Corporation's procedures, a financial analysis must be undertaken of all project proposals approved by the Panel to proceed to the appraisal stage. Under this analysis, the estimated financial costs and benefits of projects are translated into their future cash inflows and outflows.

3.12.87 The Corporation applies established capital budgeting techniques such as net present value, internal rate of return and payback to the financial analysis of projects as the basis for their economic evaluation. The net present value and internal rate of return methodologies involve the discounting of anticipated future cash flows to present day dollar values to facilitate comparisons between competing projects. The payback method determines the period of time likely to elapse before a project generates a positive return or net cash inflow.

3.12.88 While use is made of all 3 techniques, emphasis is placed by the Corporation on the payback method in its economic evaluation of potential capital projects. In this regard, projects which are likely to generate a positive return within a period of 2 to 3 years would generally be accorded a high priority ranking.

3.12.89 One of the shortcomings of a heavy emphasis on the payback method is that future estimated returns are not discounted to present day dollar values which precludes meaningful comparisons between competing projects. Use of the method also means that projects likely to generate a positive return in a short time frame will often be preferred to projects offering higher long-term financial benefits to the Corporation.

3.12.90 The Corporation's current emphasis on the payback evaluation technique for potential capital projects can adversely impact on the soundness of capital investment decisions.

Need for consideration of aggregate project costs

3.12.91 A review by audit of procedures in place at the Corporation for appraisals of potential capital projects disclosed that many appraisals did not contain information on all costs likely to be incurred over the expected useful life of the proposed capital investment. Those cost elements which were often not addressed in the documentation supporting project appraisals mainly related to operating costs such as staffing, repairs and maintenance, power, cleaning and security. The Corporation's policy guidelines relating to project appraisals actually stress the importance of inclusion of costs of this nature in the appraisal process.

3.12.92 A failure to address the total cost implications of potential capital projects may impact on the soundness of capital investment decisions, not only in terms of the absence of complete cost information, but also by impeding a valid comparison of competing project proposals. Such circumstances increase the risk to the Corporation of allocating scarce capital resources to projects with overstated net returns.

3.12.93 The Corporation should ensure that aggregate costs are taken into account in its assessment of potential capital projects.

Recognition of community service obligations

3.12.94 Because of the nature of the Corporation's responsibilities, many of its capital investment decisions relate to the achievement of important economic and social objectives of government. For example, the need to ensure that all members of the community have access to public transport facilities constitutes a fundamental social responsibility of government.

3.12.95 Over the years, no distinction has been made at the Corporation, for management and accountability purposes, between capital funding provided by government for commercially-based investment decisions and funding allocated to meet the Corporation's community service obligations in the public transport arena.

3.12.96 In its 1993-94 *Budget Paper No. 2*, the Government outlined its policy on community service obligations under which it will generally assume funding responsibility in circumstances where it directs a commercially-operating business to deliver services on other than a commercial basis. The Government also emphasised the importance of separate identification of community service obligations so that important non-commercial functions can continue to be met without jeopardising the commercial performance of an organisation.

3.12.97 In October 1993, the Minister announced that clear lines of accountability will be established for the commercial operations of the Corporation. In this respect, the Minister indicated that the Corporation would be required to enter into annual contractual arrangements with the Department of Transport. Under these arrangements, costs associated with the provision of commercial services by the Corporation are to be separated from costs incurred in the provision of community service obligations, with the Corporation to be accountable to the Department for its commercial performance.

3.12.98 At the date of preparation of this Report, the Corporation and the Department were in the process of developing a service contract, with emphasis placed to date on formulation of performance targets to be achieved by the Corporation in the delivery of services to customers. **The Department expects to have a formal service contract in place with the Corporation prior to July 1994.**

□ *RESPONSE provided by Secretary, Department of Transport*

In line with government policy, the emphasis of capital investment decisions had been to achieve quick payback on capital investment due to the limited capital funding available and the urgency to implement reform savings (many of which require initial capital investment) to assist in balancing the State budget within the Government's targeted time frame. In these circumstances, the use of the "payback" method is appropriate. It is not, however, being used to the exclusion of other techniques such as IRR and NPV, which audit noted have also been used on the same projects. Of the projects approved, all provided significant long-term savings in addition to early payback of investment.

It is Public Transport Corporation policy to include all relevant costs when evaluating projects. However, when comparing capital investment options, it is only the incremental change in life cycle costs generated by each option that needs to be brought into account in the evaluations. Existing life cycle costs which are unaffected by new capital investments are excluded from the evaluations, as investments should not be burdened with costs they cannot influence.

SCOPE FOR EXPANSION OF BOARD OF MANAGEMENT

3.12.99 Although the Corporation was established in 1989, it was not until 1992 that its enabling legislation, the *Transport Act 1983*, was amended to provide for the setting up of a board of management to oversee the organisation's strategic direction and operations.

3.12.100 Under the earlier legislation, full responsibility for strategic management rested with the Corporation's Chief Executive, with provision for an advisory board to assist the Chief Executive in this role.

3.12.101 The 1992 amending legislation specifies that membership of the board of management shall consist of:

- a Chairperson appointed by the Minister;
- the Corporation's Chief Executive; and
- 2 people appointed by the Minister who have such managerial or other qualifications as the Minister considers necessary to enable the board to carry out its functions.

3.12.102 Since early 1993, a 2 person board of management, comprising only the Corporation's Chairperson and Chief Executive has been in place.

3.12.103 The Corporation's key statutory responsibility, the operation and management of the State's public transport system, involving assets with an aggregate value at 30 June 1993 of approximately \$4.6 billion, is clearly a major business activity. Also, over recent years, its operations have been increasingly driven by commercial principles. Some measure of this latter point can be derived from the range and significance of decisions which underpin the Minister's January 1993 transport reform statement, commented upon in earlier paragraphs of this Report.

3.12.104 It follows, therefore, that the strategic management framework of the Corporation should ideally mirror that of other major business enterprises within the public sector. Most of these enterprises now operate with full boards of management comprising members drawn predominantly from external sources and representing a carefully balanced mix of skills and expertise appropriate to the operational environment of the entity.

3.12.105 Given the magnitude and complexity of the Corporation's operations, consideration should be given to expanding the board of management in line with the membership level authorised by the legislation.

□ RESPONSE provided by Secretary, Department of Transport

The Minister for Public Transport is currently considering the appointment of additional members to the Board.

ROADS CORPORATION**MULTI-PURPOSE TAXI PROGRAM****Background**

3.12.106 In June 1982, the Minister for Transport initiated planning for the development of a special taxi service for people with disabilities. In November of that year, the Government announced the introduction of a program, known as the Multi-Purpose Taxi Program, to improve access of people with disabilities to jobs, community services and recreation through the provision of subsidised taxi travel. The Program became operational in 1983 and provided people with mobility-related disabilities with an entitlement to a 50 per cent subsidy, subject to a maximum subsidy of \$25 on any taxi fare incurred.

3.12.107 The Department of Transport is responsible for overseeing and advising the Government on policy matters relating to the Program. Day-to-day responsibility for the administration of the Program rests with the Roads Corporation (Vic Roads).

3.12.108 People wishing to join the Program must submit an application form to Vic Roads, which includes evidence supplied and certified by a medical practitioner as to the nature of the applicant's permanent disability and how it prevents independent access to bus and tram services. Staff of Vic Roads assess applications against the Program's eligibility criteria and may request qualified medical assistance in the review of more difficult applications. Final decisions on admission to membership are made by Vic Roads.

3.12.109 Under the Program, eligible people are issued with a membership card which is used to obtain the 50 per cent subsidy on metered taxi fares. The card details the member's name and membership number and provides for the member's signature (the requirement to sign the card is dispensed with if there is an incapacity to sign due to physical or intellectual disability).

3.12.110 On completion of a taxi trip, the driver records on a docket the fare incurred and other details of the trip, including time and points of departure and arrival. After verification by the member, the taxi driver imprints the membership card onto the docket. The driver and member then sign the docket. The member pays half of the metered fare, while the driver submits the docket to Vic Roads for reimbursement of the unpaid portion of the fare.

3.12.111 At 30 June 1993, there were 123 400 individuals participating in the Program. For the 1992-93 financial year, Vic Roads outlayed \$17 million on subsidised taxi fares under the Program. The Government has provided a budget allocation of \$19 million in 1993-94 and at 31 January 1994, \$10.1 million had been expended.

3.12.112 Audit carried out a review of the Program's operations with particular emphasis directed towards mechanisms in place for assessing the Program's effectiveness, the soundness of management information systems and the adequacy of fraud management controls.

OVERALL CONCLUSION

3.12.113 Since its inception in 1982, the Multi-Purpose Taxi Program has expanded far beyond initial expectations to the point where it is by far the largest government scheme of its type in Australia with a participation rate substantially higher than the combined aggregate number for all other States.

3.12.114 The main factors impacting on the growth in membership levels have been an absence of clear objectives for the Program and the use of loosely-framed criteria for determining eligibility. As a consequence, a structured framework has not been in place to guide strategic decisions on the overall direction of the Program and enable systematic monitoring of the Program's effectiveness. In such circumstances, audit was not in a position to reach any conclusions on the effectiveness of the Program.

3.12.115 Although a need to establish a definitive set of objectives for the Program was identified as far back as 1987, no conclusive action has been taken and, as a result, the Program has progressively expanded over the years in size and cost. There is a strong social purpose underpinning a program of this nature and the ambit of this social purpose is essentially a government policy decision. The Government is currently reviewing the Program's operations and, irrespective of the outcome of this review, the development of clear goals and scope for the Program requires, in audit opinion, priority attention.

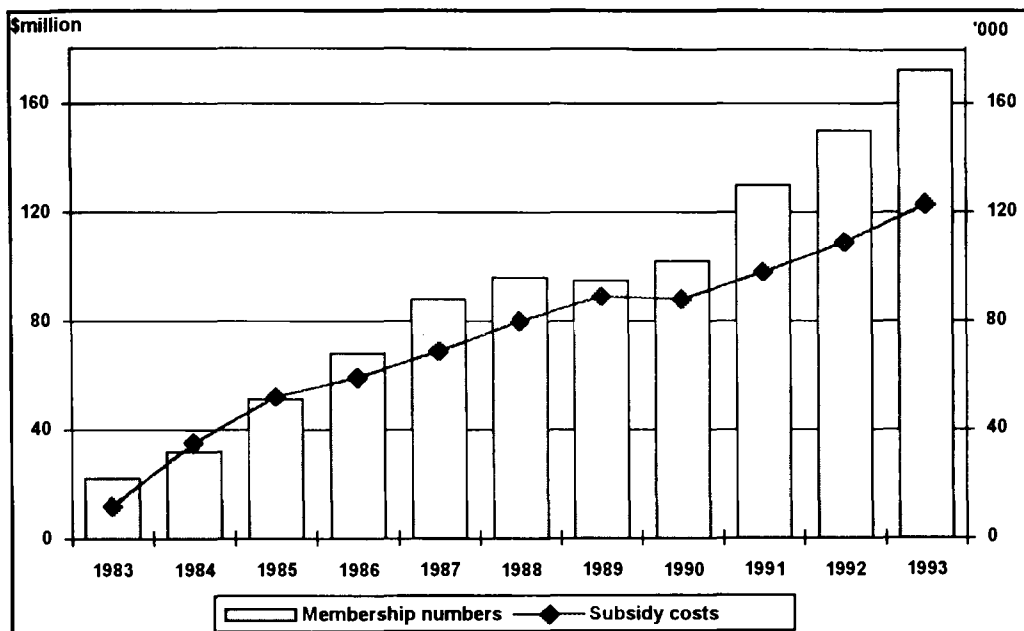
3.12.116 The audit review also identified the need to reassess the adequacy of fraud management strategies relating to the Program. Until action is taken to upgrade the quality of information used to guide investigations, decisions on the allocation of scarce resources for investigative purposes may not be soundly-based, directed to areas of material impact and likely to result in cost-effective outcomes.

Growth of the Program

3.12.117 One of the distinctive characteristics of the Program, which became evident to audit at the early stages of the review, was the marked growth in membership numbers and subsidy costs which had occurred over the years.

3.12.118 The Program's overall expansion since its inception is illustrated in Chart 3.12D which discloses the movement in annual membership numbers and subsidy costs over the 10 year period to 1992-93. The annual subsidy costs (which represent the half share of fares paid by Vic Roads to taxi operators for eligible taxi trips undertaken by people with disabilities) have been expressed in 1992-93 dollar terms, based on Australian Bureau of Statistics Implicit Price Deflators for Gross Non-Farm Product.

CHART 3.12D
GROWTH IN PROGRAM MEMBERSHIP AND SUBSIDY COSTS
OVER 10 YEAR PERIOD TO 1992-93
 (Financial year ended 30 June)



3.12.119 Over the last 4 years, membership of the Program has grown from approximately 87 600 in 1989-90 to around 123 400 in 1992-93 (an increase of 40 per cent). During the same period, annual subsidy costs of the Program increased from \$10.3 million in 1989-90 to \$17.2 million in 1992-93, which represents a real increase of around 67 per cent.

3.12.120 A further indication of the size of the Victorian program can be gleaned from a comparison with similar taxi assistance programs operating interstate. Table 3.12E, which was compiled from information provided to audit by Vic Roads and the various organisations responsible for the interstate taxi programs, compares membership numbers and subsidy costs for the Victorian program, at 30 June 1993, with equivalent data relating to the interstate programs.

TABLE 3.12E
COMPARISONS WITH INTERSTATE TAXI PROGRAMS, AT 30 JUNE 1993

Details	Vic.	NSW	Qld	SA	WA	Tas.
Year program established	1982-83	1981-82	1987-88	1986-87	1988-89	1985-86
No. of members	123 400	27 700	19 600	21 200	8 500	4 200
1992-93 subsidy cost	\$17.2m	\$5.5m	\$2.4m	\$2.5m	\$1.1m	\$0.3m
Average yearly cost per member	\$139	\$200	\$124	\$118	\$133	\$86
No. of members as a % of State population (a)	2.77	0.46	0.63	1.45	0.51	0.89

(a) Source: Australian Bureau of Statistics, *Australian Demographic Statistics*, 1993.

3.12.121 It can be seen from the above table that the participation rate and the overall cost of the Victorian program at 30 June 1993 were substantially higher than the other States. In fact, the Program is by far the largest government assistance scheme of its type in Australia with the number of members at 30 June 1993 over 50 per cent higher than the combined aggregate number for all other States.

3.12.122 There is an established trend within Australia towards an ageing population. According to the Australian Bureau of Statistics, the aged population in Victoria (persons 60 years and over) increased by 8 per cent between 1986 and 1991 and is expected to increase by a further 24 per cent between 1991 and 2001.

3.12.123 Because the Victorian program largely consists of members with age-related disabilities, 86 per cent of participants are over 60 years of age, future patterns of growth in membership numbers and subsidy costs are likely to be even greater than those experienced in past years, in the absence of any variations in program conditions.

What factors have contributed to the current size of the Victorian program?

3.12.124 When analysing the past growth patterns, audit sought to identify those factors which were likely to have contributed to the current size of the Program. Audit concluded that the main factors impacting on the growth in membership levels were:

- an absence of clear objectives for the Program; and
- the use of loosely-framed criteria for determining eligibility for membership.

3.12.125 Without specific objectives and clear eligibility criteria to complement an initial broad aim of the Program, there has been an absence, over the years, of a structured framework to guide key decisions on the Program's direction and to enable periodic assessments of the Program's effectiveness.

3.12.126 There is a strong social purpose underpinning the establishment of a program of this nature and the ambit of this social purpose is essentially a government policy decision. Audit has been advised by the Department of Transport and Vic Roads that the Program's operations are currently under review. Irrespective of the outcome of the Government's review and its subsequent assessment of the future boundaries of the Program's social ambit (which might involve retention of the Program in its current form or expansion or contraction of operations), **it is vital that a definitive set of objectives and a structured operational framework be developed to provide clear direction for the Program's operations and facilitate systematic monitoring of the Program's effectiveness.**

Absence of clear objectives for the Program

3.12.127 At the time of establishment of the Program in 1982, the Government accorded it a very broad purpose of improving access of people with disabilities to jobs, community services and recreation. A special ministerial advisory committee was established, at that time, to design the Program and formulate eligibility criteria for membership. This committee operated up until 1988 and was responsible for overseeing the operations of the Program.

3.12.128 There was limited information available to audit at Vic Roads concerning the early development of objectives and scope for the Program beyond the broad Government aim referred to above. However, documentation held by Vic Roads indicated that there was an intention to develop the Program along the lines of an equivalent program established in NSW in 1981. Preliminary forecasts prepared in 1982, which related to the anticipated growth in membership numbers and program costs of a Victorian program, were based on early growth targets established for the NSW scheme.

3.12.129 In 1987, the former Road Traffic Authority (a predecessor body of Vic Roads which operated up to 1989) received funding, under a joint Commonwealth and State Home and Community Care Program, to evaluate the taxi program. This evaluation, which was carried out by external consultants, took the form of a wide-ranging exercise aimed at assessing the overall efficiency and effectiveness of the taxi program.

3.12.130 The consultants found that extremely limited documentation was available in relation to the objectives of the Program, both at the time of its establishment and throughout the following 4 years of its operations. At the time of the consultancy review, the Program purpose, as stated on the membership application form, had been varied from its initial broad form to read in the following terms:

"... to assist people who have a permanent disability which denies them independent access to bus, tram and train services".

3.12.131 In their July 1987 report, the consultants commented as follows on the purpose of the Program:

"The intent of the Program, loosely expressed, included concepts such as equity of access ..., quality of life and the ability to attend employment ... clear and concise documentation on such issues was not able to be located. Only the memory of individuals has been relied upon to establish the above picture".

3.12.132 They concluded that, in the absence of a set of specific objectives and a definitive scope, it was difficult to accurately evaluate the effectiveness of the Program. The consultants stated on this point that:

"... the Program was based on a broad statement of intent, rather than a set of detailed, measurable objectives. In the absence of such specific objectives indicating the intended scope of the Program and containing monitoring mechanisms, it is difficult to accurately evaluate the Program and its implementation process".

3.12.133 The consultants recommended the establishment of clear goals and objectives, with identified target groups and specified outcomes to be achieved over a series of time frames.

3.12.134 There has only been a slight variation in the overall aim of the Program since the consultants' review. The Program purpose as stated on the current application form now reads as follows:

"The Multi-Purpose Taxi Program is designed to assist people who have a permanent disability which denies them independent access to bus and tram services and whose mobility is severely limited by their disability".

3.12.135 Audit held discussions with representatives of Vic Roads on the nature of action, apart from the above minor variation in wording of program purpose, which has been taken since 1987 on the recommendations of the consultants. Audit concluded that, until late 1992 when a government review of the Program commenced (this review is not yet finalised), no specific action had been taken to establish a definitive set of objectives or a structured framework which would enable systematic monitoring of effectiveness.

3.12.136 **Clear objectives need to be established to guide strategic decisions on the overall direction of the Program and provide the basis for progressive monitoring of performance.**

Loosely-framed eligibility criteria for membership of the Program

3.12.137 As mentioned in an earlier paragraph, responsibility for the establishment of eligibility criteria for membership of the Program was assigned in 1982 to a ministerial advisory committee. At its inaugural meeting held in November 1982, the committee established, in the following terms, the eligibility criteria to apply when assessing applications for membership of the Program:

"The Program will be available to people whose disabilities deny them access to the public transport system. Any disability which would prevent a person from undertaking one or more of the following actions within a reasonable time would qualify that person for admittance to the scheme:

- *movement from home to [public transport vehicle] pick-up point;*
- *entering the [public transport] vehicle - this involves the need to climb one or 2 steps;*
- *standing or sitting in the standard seats of the public transport vehicle;*
- *leave the [public transport] vehicle by descending one or 2 steps; and*
- *moving to final destination".*

3.12.138 Eligibility criteria contained in a later public information sheet available from Vic Roads disclosed that:

"If your disability prevents you from undertaking one or more of the following actions you may be eligible:

- *walking without the use of complex aids;*
- *entering a public transport vehicle by climbing one to 2 steps; and*
- *travelling on public transport unaccompanied".*

3.12.139 Based on the initial criteria, the advisory committee in the early days of the Program's operations formulated a list of 10 disabilities to be used as a guide to assist Vic Roads staff in the determination of eligibility for program membership. **By January 1994, there were 226 disabilities listed to assist Vic Roads staff in assessing admissibility for membership of the Program.**

3.12.140 To provide some comparison with the Victorian program, the eligibility criteria developed for the equivalent scheme in NSW were reviewed by audit. In that State, an applicant's disability or mobility limitation must fall within one of the following 6 categories:

- *"Permanent inability to walk;*
- *Total permanent dependence on a wheelchair;*
- *Severe permanent ambulatory [walking] problems:*
 - *Necessitating permanent use of large complex walking aids, e.g. walking frame, crutches or splints. Walking sticks or "quad" [4-point] sticks do not qualify; or*
 - *Necessitating constant assistance of another person for mobility.*
- *Total loss of vision or severe permanent vision impairment;*
- *Severe and uncontrollable epilepsy; or*
- *Intellectual disabilities causing behavioural problems:*
 - *resulting in socially unacceptable behaviour; or*
 - *requiring the constant assistance of another person for travel on public transport".*

3.12.141 The eligibility criteria used for assessing applications for membership of the Victorian program have been framed in more general terms than those used in NSW. This use of general terminology has led, over the years, to a wide range of interpretations on eligibility conditions for membership. As a consequence, a variety of disabilities has progressively been recognised for membership of the Program.

3.12.142 During discussions with representatives of Vic Roads, audit was informed that a major difference in the membership composition of the Victorian and NSW programs was the significantly higher number of people with age-related, degenerative conditions (mainly arthritis and heart ailments), accepted as members in the Victorian program. Statistics held by Vic Roads on the membership profile of the Program disclose that arthritis and heart disease are the most common disabilities affecting members. The most recent information available from Vic Roads on the membership profile was compiled as at 31 March 1992 and showed that 58 per cent of members suffered from the above disabilities (with 40 per cent affected by arthritis and 18 per cent by heart ailments).

3.12.143 Comparative statistics were not available from NSW on the number of members with arthritis or heart conditions, although 65 per cent of members in that State are over 60 years of age compared with 86 per cent in the Victorian program. Under the NSW eligibility criteria, degenerative conditions associated with the ageing process do not automatically qualify a person for membership. The applicant must still meet the specific criteria detailed above.

3.12.144 A failure to establish clear objectives and scope for the Program from its inception was accompanied by the development of broad membership eligibility criteria which have been subject to wide interpretation. The consequence for the Program of a combination of extremely broad aims and eligibility criteria has been a substantial expansion of membership numbers and subsidy costs.

Management control framework

3.12.145 The audit review of the Program encompassed an assessment of the adequacy of fraud management controls in place and the soundness of management information systems relating to the Program.

3.12.146 The importance of having in place effective fraud management controls is reinforced by the fact that some of the Program's specific operational characteristics render it susceptible to unauthorised or fraudulent activity. These characteristics include:

- heavy reliance must be placed on the honesty and integrity of taxi drivers and members;
- the absence of incentives or motives for taxi drivers and members to be alert to each other's activities (i.e. there is little impact on members if a driver is involved in a fraudulent action, such as inflating the fare incurred on travel docket submitted to Vic Roads for reimbursement, as the benefit of subsidised travel is still realised by participants and, similarly, drivers' entitlements to subsidy reimbursements are not affected by the passing of members' cards to non-members such as family and friends for unauthorised use); and
- there is potential for collusion to occur between drivers and members.

3.12.147 With core program activities involving interaction between drivers and members substantially distanced from the direct control of Vic Roads, a key challenge for Vic Roads is to ensure that management of its scarce investigative resources for the Program is based on a systematic assessment of the risk of fraud and addresses fraud in a cost-effective manner.

3.12.148 Up until 1992, responsibility at Vic Roads for the investigation of program fraud was part of the functions of its transport safety services section. Fraud surveillance activities conducted by this section tended to be on an ad hoc basis with decisions on the need to initiate investigations in a particular area principally determined by officers from the section.

3.12.149 Separate records were not maintained on the costs of the investigations and their ultimate outcomes. However, audit was advised by Vic Roads that investigations were invariably difficult in nature and often required time-consuming and costly techniques, for example, detailed observations of subsidised travel trips and passenger interviews, in an attempt to obtain sufficient evidential matter to sustain charges.

3.12.150 In December 1992, Vic Roads established a special investigations branch as an important strategic measure to upgrade the effectiveness of fraud management within the organisation. In the period up to February 1994, 29 investigations related to the Program were initiated by this branch and to date, 6 cases involving suspected fraud of \$16 000 have been referred for police action. In 3 of these cases, fraud charges have been laid with charges pending in relation to the remaining 3 cases.

3.12.151 While the establishment of a special investigations branch within Vic Roads enabled a greater focus to be directed towards fraud management generally, Vic Roads were not in a position to estimate, with any reasonable confidence, the extent of fraudulent activity within the Program. This situation is principally due to weaknesses in the information utilised to analyse program activity and identify areas with potential for investigation. **Until these weaknesses are addressed, decisions on the allocation of scarce resources for investigative purposes may not be soundly-based, directed to areas of material impact or result in cost-effective outcomes.**

3.12.152 The main shortcoming with information systems identified by audit related to the fact that certain critical data (for example, taxi driver identification numbers recorded on travel dockets) was not retained by VicRoads to enable systematic time series analyses of long-term patterns or trends. In addition, periodic reports, which stratified members' use of the Program based on the number of taxi trips taken had not been prepared and examined for the purpose of identifying areas which may have potential for investigation.

3.12.153 To illustrate the potential benefits of information relating to members' participation in the Program, audit arranged during the course of the review for the preparation of a special data interrogation report which stratified subsidised travel by members for 1992-93 based on taxi trips taken during the year. This report disclosed that 9 000 members (7.3 per cent of those participating in the Program) took 50 per cent of the total number of taxi trips for the year, at a total subsidy cost of \$7.9 million. More detailed analysis indicated:

- 262 members had made between 400 and 500 trips;
- 121 members " " " 500 and 600 trips;
- 85 members " " " 600 and 1 100 trips; and
- 2 members had made in excess of 1 100 trips.

3.12.154 While audit does not suggest that extensive use of the Program by particular members is indicative, in itself, of unauthorised or inappropriate practices, information of this nature would certainly be very useful for directing the attention of limited investigative resources to more material elements of the Program's operations.

3.12.155 In September 1992, Vic Roads commenced action to improve the quality of the Program's management information systems, including consideration of the feasibility of contracting-out a number of the Program's functions. In this regard, draft tender documents were developed for outsourcing responsibility for the implementation and administration of a quality management information system. Part of the responsibilities to be assigned to the appointed contractor involved the provision of periodic reports on the following categories of information which would be used to assist in the identification of areas with potential for investigation:

- number and details of trips involving over-lapping start or finish times;
- extensive travel involving the same driver and member in terms of the number of trips or dollar value;
- drivers who consistently submit claims for reimbursement in respect of a high number of trips or dollar value for a given period; and
- details of members' trips when the number of trips or dollar value is in excess of a set benchmark in a given period.

3.12.156 Although these 1992 proposals offered substantial scope to upgrade the quality of fraud surveillance, audit was advised that the Department of Transport determined not to proceed beyond the completion of draft tender documentation. In this respect further action on the outsourcing of program functions was deferred pending the outcome of a wider review by the Government of the future direction of the Program.

3.12.157 The availability of the above reports on a periodic basis would substantially improve the quality of information used for decision making and lead to more effective scrutiny of the Program. In discussions with Vic Roads, audit suggested that an additional report, identifying the number and details of trips taken where claimed fares exceeded reasonableness limits established by Vic Roads for travelled distances, be considered for inclusion in the list of proposed new reports. In addition, audit suggested that consideration be given to the implementation of periodic assessments (e.g. every 5 years) of members' continuing eligibility for membership of the Program. In this respect, although the Program is open to people with permanent disabilities, a member's eligibility status may change over time through continuing developments in available medical treatments.

3.12.158 Substantial scope exists to upgrade the quality of information utilised for reaching decisions on the allocation of its scarce investigative resources to areas involving potential fraud within the Program.

Current initiatives to improve the Program

3.12.159 The operations of the Program have been subject to review by Vic Roads since late 1992. Audit was informed that this review process has principally been directed towards the appropriateness of the Program's objectives and related eligibility criteria for membership. Recommendations arising from the review have been submitted for consideration by the Minister for Roads and Ports. At the date of preparation of this Report, final decisions by the Government on the outcome of the review had not been reached.

3.12.160 In December 1993, the Minister announced the establishment of a new Taxi Directorate within the Department of Transport to bring the administration of all activities associated with taxi regulation in the State under the control of a single government organisation. As part of its functions, the Directorate has assumed responsibility for administration of the Multi-Purpose Taxi Program.

□ *RESPONSE provided by Secretary, Department of Transport*

The Department is generally in agreement with the conclusions drawn by audit regarding the Multi-Purpose Taxi (MPT) Program.

However, in the Department's view, audit's analysis of the reasons for the Program's rapid growth, which it attributes to the "... absence of clear objectives ... and the use of loosely-framed criteria for determining eligibility" is limited.

While there is scope for clarifying objectives and tightening eligibility criteria, the major reason for the Program's size and growth lies in the fact that its objectives and, consequently, its eligibility criteria, were made and remained intentionally broad. These broad criteria were in line with previous government policy and with the characteristics of the public transport system at the time.

The Program was structured in such a way that it linked eligibility to difficulty in accessing the mainstream public transport system. The linkage set up the very broad potential membership base of the Program, which other States have avoided by largely divorcing tests of eligibility from ability to independently access public transport. Under this latter approach, many people who are not able to use trains, trams or buses would not qualify for membership.

The approach in Victoria has also created a heavy dependence on the subjective judgement or honesty of the applicant and/or the applicant's doctor in assessing eligibility. More stringent assessment/review procedures are under consideration, although past experience indicates that while the basic entry criteria remain broad, such measures are unlikely to significantly reduce the Program's growth rate.

Membership growth in the Program in recent years has also been accelerated by policy changes and program reforms in other portfolios which have resulted in a contraction of direct provision of transport services in these areas, particularly for people travelling to and from day activity/therapy centres of various kinds.

In order to improve management control of the Program, a range of measures to enhance fraud detection and prevention have been introduced. Alternative systems of operation which may reduce the opportunities for fraud or over-use are also under investigation.

The Government has recently established the Victorian Taxi Directorate within the Department of Transport to assume direct responsibility for all taxi policy and operational matters, including the MPT Program. A high priority for the new Directorate, which commenced operations on 14 February 1994, will be tighter administration of the Program to reduce fraud and related abuse.

The Directorate is also currently developing a range of policy options for reform of the Program for consideration by the Minister and the Government. These options will involve consideration of revised eligibility criteria which target those most in need of assistance and a review of the level of benefits available under the existing Program.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
MATTERS RESOLVED OR ACTION COMMENCED		
PUBLIC TRANSPORT CORPORATION		
<i>Second Report, 1985-86, pp. 166, 178. Ministerial Portfolios, May 1989, p. 256. May 1990, p. 304.</i>	Excessive accumulation of employee leave credits.	Although attempts have been made to reduce the level of excessive leave credits, the position remains unsatisfactory. For example at 30 June 1993 some 1 800 employees had more than 60 days leave credits.
<i>Ministerial Portfolios, April 1991, pp. 423-4.</i>	Borrowing by way of sale and lease-back arrangements have been incorrectly classified by the Corporation as operating leases.	Matter is now resolved. Following recognition by the Government that the sale and leaseback arrangements constituted finance leases, the Corporation was able to correct the classification of the arrangements within its financial statements.
<i>Ministerial Portfolios, May 1993, pp. 255-64.</i>	At 31 March 1993, the Corporation held 63 light rail vehicles in excess of immediate service needs. Audit estimated that around \$126 million had been prematurely outlaid by the State since 1990 to acquire these vehicles. At May 1993 the Corporation had a total of 227 trams in excess of requirements.	The Corporation has initiated action aimed at progressively reducing the overall level of its tram fleet by 145 vehicles by 1995-96. To achieve this goal the Corporation intends to dramatically reduce its fleet of W class trams while slightly increasing the fleet of light rail vehicles in line with its contractual obligations.
<i>Ministerial Portfolios, May 1993, pp. 262-3.</i>	The Corporation could not account for or locate Met Ticket equipment with a value of \$508 000 purchased for the conversion to driver-only trams. At the time of the audit review, the Corporation had announced that its newly-formed internal audit section would be undertaking a further investigation into this matter.	The Corporation has strengthened its procedures for the disposal of surplus assets. The internal audit investigation into the missing Met ticket equipment was carried out during 1993, however, it is understood that the results of this review have not yet been formally reported to the Corporation.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued

Report	Subject	Status at date of preparation of this Report
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MATTERS RESOLVED OR ACTION COMMENCED - continued

PORT OF GEELONG AUTHORITY

<p><i>Ministerial Portfolios, May 1993, pp. 266-70.</i></p>	<p>There is low utilisation of the Authorities multi-purpose berths and the Authority should identify and decommission those berths no longer required.</p>	<p>The Authority has developed a program aimed at disposing of berths no longer required for Port purposes. Action under the program has been deferred pending the outcome of a Government review of the State's Ports operations.</p>
<p><i>Ministerial Portfolios, May 1993, p. 271.</i></p>	<p>The Authority will need to secure firm financial commitments from Port users if its proposed channel deepening program is carried out.</p>	<p>Negotiations have taken place with Port users on matters associated with funding of this channel deepening program, however the final outcome of these negotiations will be influenced by the findings of the current review by the Government into Ports operations.</p>

ROADS CORPORATION

<p><i>Ministerial Portfolios, May 1993, pp. 390-3.</i></p>	<p>Potential exists for the abuse of pensioner concessions for transport accident and motor registration charges due to weaknesses in the governing regulations.</p>	<p>The Corporation has taken action to minimise the granting of pensioner concessions to ineligible vehicle owners, however, the government regulations have not been amended to eliminate the potential abuse of the system under which pensioners without a drivers licence obtain concessional benefits.</p>
<p><i>Ministerial Portfolios, May 1993, pp. 295-7.</i></p>	<p>Significant loss of funds to the Corporation as the result of the assumption of responsibilities transferred from the Public Transport Corporation.</p>	<p>Position resolved. All transfers of responsibilities between the 2 organisations are now accompanied by provision of related funding.</p>
<p><i>Ministerial Portfolios, May 1993, pp. 285-92.</i></p>	<p>Likelihood of substantial increase in overall cost of road maintenance if current funding patterns continue. The Corporation had substantially finalised development of a road maintenance strategy which had identified an optimum funding level for annual road maintenance and which would minimise, through improved road conditions, vehicle operating costs incurred by vehicle owners.</p>	<p>In August 1993, the Government formally adopted the Corporation's road maintenance strategy. In addition, funding for road maintenance in 1993-94 was increased to \$119 million (\$90 million; 1992-93) which was consistent with the optimum annual funding level identified in the strategy.</p>

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS - continued

Report	Subject	Status at date of preparation of this Report
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MATTERS RESOLVED OR ACTION COMMENCED - continued

ROADS CORPORATION - continued

<p><i>Ministerial Portfolios, May 1993, pp. 293-4.</i></p>	<p>Significant safety and funding implications could emerge if action is not taken to address the general deterioration in the condition of many bridges.</p>	<p>The Corporation has taken action to improve its maintenance planning and budgeting for the bridge network through the development of a Bridge Maintenance Program Strategy which is substantially finalised.</p>
<p><i>Ministerial Portfolios, May 1993, pp. 295-6.</i></p>	<p>The Corporations had initiated strategies aimed at removal of a number of restrictive work practices.</p>	<p>An agreement was entered into with the relevant unions effective from December 1993 which provides for the elimination of restrictive work practices.</p>

NO ACTION TAKEN

PUBLIC TRANSPORT CORPORATION

<p><i>Ministerial Portfolios, May 1989, p. 236.</i></p>	<p>The adequacy and quality of disclosure within the financial reports of the transport authorities is inadequate because financing costs related to centralised debt are not included.</p>	<p>Position unchanged. Finance costs for transport are reported centrally in the <i>Finance Statement</i> under Program 727.</p>
<p><i>Ministerial Portfolios, May 1989, p. 238.</i></p>	<p>Internal management reporting and oversight by central agencies of inner budget agencies (PTC, Roads Corporation) are based on cash data whereas year-end external reporting is based on accrual accounting principles.</p>	<p>Position unchanged. Monitoring of cash appropriated by the budget process is still regarded as an essential aspect of internal management control over funds available to inner budget agencies and is treated separately to accrual accounting.</p>

**SCHEDULE B
COMPLETED/INCOMPLETE AUDITS**

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor- General's report signed</i>
COMPLETED AUDITS				
Department of Transport	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s.8.</i>	28 Oct. 1993	28 Oct. 1993
MTA Investments Pty Ltd	30 June 1993	No reporting requirements. Audit conducted at request of Treasurer and under the Corporations Law.	21 Sept. 1993	14 Oct. 1993
MTA Superannuation Fund	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i> Extension granted to 30 Nov. 1993	21 Sept. 1993	13 Oct. 1993
Public Transport Corporation	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	24 Sept. 1993	24 Sept. 1993
Marine Board of Victoria	30 June 1993	30 Sept. <i>Marine Act 1988, s.80.</i>	20 Sept. 1993	30 Sept. 1993
Port of Geelong Authority	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	3 Sept. 1993	13 Sept. 1993 (a)
Port of Geelong Authority Superannuation Fund	30 June 1993	No reporting requirements. Section 4 of Port of Geelong Authority (Superannuation) Regulations 1972 requires the Superannuation Fund to be audited by the Auditor-General.	3 Sept. 1993	13 Sept. 1993
Port of Melbourne Authority	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	17 Sept. 1993	24 Sept. 1993 (a)
Port of Portland Authority	30 June 1993	" "	10 Aug. 1993	16 Sept. 1993
Roads Corporation	30 June 1993	" "	29 Sept. 1993	30 Sept. 1993

(a) Qualified audit report issued.

Part 3.13

Treasurer

KEY FINDINGS

TRANSPORT ACCIDENT COMMISSION

History of strong financial performance

- The Commission's strong financial position has been the outcome of a combination of its commendable management performance and the significant contributions made by Victorian motorists to its reserves.
Paras 3.13.9 to 3.13.17
- At 31 December 1993, each Victorian motorist had contributed around \$400 to the Commission's surplus holdings.
Paras 3.13.13 to 3.13.14
- Around 76 per cent of holders of Victorian Government Security Bonds accepted the Commission's offer to redeem outstanding bonds.
Paras 3.13.18 to 3.13.20
- While, in financial terms, the Commission has forgone income of around \$5.3 million as a result of its buyback offer, other factors such as the impact on the State's economy need to be taken into account when evaluating the merits of the arrangements.
Paras 3.13.21 to 3.13.22
- Although the level of compulsory charges levied on Victorian motorists over the years may be regarded as excessive, taxpayers as a whole are now benefiting from the Commission's financial growth.
Paras 3.13.26 to 3.13.33

3.13.1 The Treasurer has responsibility for operations within the Treasury sector. Details of the specific ministerial responsibility for public bodies within the Treasury sector are listed in Table 3.13A. These public bodies, together with the Department of the Treasury, are subject to audit by the Auditor-General.

TABLE 3.13A
MINISTERIAL RESPONSIBILITY WITHIN THE TREASURY SECTOR

<i>Ministerial portfolio</i>	<i>Entities subject to audit</i>
Treasurer	Rural Finance Corporation State Insurance Office Tattersall Sweep Consultation Transport Accident Commission Treasury Corporation of Victoria Victorian Debt Retirement Fund Victorian Development Fund

3.13.2 Comment on matters of significance arising from the audit of the Transport Accident Commission is provided below.

TRANSPORT ACCIDENT COMMISSION

HISTORY OF STRONG FINANCIAL PERFORMANCE

3.13.3 For some years now, Reports of the Auditor-General to the Parliament have included analyses of the Commission's financial position and performance. These analyses have illustrated the steady strengthening of the Commission's financial structure which has occurred since it was established in 1987 to manage the State's transport accident scheme.

3.13.4 The *Auditor-General's Report on Ministerial Portfolios, April 1991*, provided an early indication of the escalating strength of the Commission's profitability and reserve levels. That Report showed that the transport accident scheme became fully-funded during 1989-90, some 7 years ahead of a target year of 1997 set at the time of the Commission's formation. The Report also indicated that, based on actuarial projections, the scheme would be 147 per cent funded by 1997, which would equate to a surplus position estimated to be \$1.9 billion.

3.13.5 Beyond 1989-90, the Commission's financial position continued to rapidly strengthen. Table 3.13B shows the Commission's profit results and solvency levels (reserves compared with outstanding claims) at the end of the financial years ended 30 June 1991, 1992 and 1993.

TABLE 3.13B
**COMMISSION PROFITS AND SOLVENCY LEVELS FOR 3 YEAR PERIOD TO
30 JUNE 1993**

		1990-91	1991-92	1992-93
Operating profit	(\$m)	376	501	924
Extraordinary Item	(\$m)	-	-	521
Operating profit after extraordinary item	(\$m)	376	501	403
Solvency level	(%)	23	40	63

3.13.6 The extraordinary item of \$521 million in 1992-93 represented the financial impact, expressed in present value terms at 30 June 1993, of all obligations arising from the failure of the Farrow Group of Building Societies. These obligations had been transferred to the Commission by the Government in January 1993 and relevant details of this transfer were incorporated in the *Auditor-General's Report on Ministerial Portfolios, May 1993* and updated in the *Report on the Finance Statement, October 1993*. As illustrated in Table 3.13B, the Commission's financial position further strengthened during 1992-93 with a profit of \$403 million after accounting for the full effect of the Farrow obligations.

3.13.7 During the 6 months ended 31 December 1993, the trend in financial growth continued with reserves of the Commission increasing by \$402 million (after providing \$209 million for taxation) to an aggregate level of \$1.7 billion and its solvency level rising from 63 per cent to 81 per cent. This significant improvement was principally due to income earned from the Commission's equity investments.

3.13.8 In summary, the operations of the Commission since its formation in 1987 have been characterised by sustained profitability and growth in financial reserves.

Factors influencing strong financial performance

3.13.9 Four principal factors have contributed to the exceptional rate of financial growth experienced by the Commission over the years. These factors, which need to be considered collectively, are summarised below:

Over-estimation of inherited liability by \$1 billion

3.13.10 At 1 January 1987, the Commission inherited from the State's former compulsory third party scheme an outstanding claims liability which was actuarially estimated at that time to be just over \$2 billion. At the end of each subsequent financial period, the Commission's actuaries have reassessed the initial claims liability. At 30 June 1993, the cumulative actuarial assessment of the inherited liability was that it had been over-estimated by around \$1 billion. Over the intervening years, financial gains equivalent to this amount have been progressively reflected in the Commission's financial results.

□ RESPONSE *provided by Chief Executive Officer, Transport Accident Commission*

When TAC took over approximately 60 000 claims from SIO it embarked on an aggressive new strategy for claims management. The strategy included:

- greater emphasis on fraud detection;*
- improved claim management practices; and*
- intensive pre-trial conferencing.*

As a result, savings of around \$1 billion have been achieved against actuarial expectations based on previous trends.

Reduction in claim payments for new scheme

3.13.11 Since 1989-90, there has been a substantial decline in the number of road accidents in Victoria and of injuries resulting from these accidents. The Commission considers that a number of road safety and accident prevention initiatives introduced within the State, including speed cameras and mobile breath testing stations which have been provided by the Commission, and the Commission's major advertising campaigns over recent years aimed at improving motorist driving habits are contributing factors to this reduction.

3.13.12 The lower incidence of road accidents has resulted in the number of no fault claims falling from 22 500 in 1988-89 to 16 950 in 1992-93 (under the Commission's scheme, claimants are not required to substantiate their no fault status). This substantial reduction in claims has progressively led to a lower liability to the Commission for compensation payments. As a consequence, the Commission's actuaries have periodically adjusted the conservative estimates of the outstanding claims liability made in earlier years, with an aggregate favourable impact to the Commission's reported financial results to 30 June 1993 of around \$716 million. These adjustments were additional to the above mentioned adjustments to the inherited liability of \$1 billion.

□ **RESPONSE** provided by Chief Executive Officer, Transport Accident Commission

Further savings have been made by TAC in the New Scheme with progressive savings arising from continuous reductions in new claim numbers. The reductions have been the result of the "hard hitting" accident prevention programs and the continuation of a strong anti-fraud strategy, in addition to the refinement of actuarial assumptions in light of emerging claims experience.

Maintenance of the level of transport accident charge

3.13.13 At the inception of the scheme, the compulsory annual transport accident charge levied on motorists was actuarially calculated at a rate that would cover the inherited outstanding claims liability of \$1 billion and enable the scheme to be fully funded by 1997. Although, as previously mentioned, the scheme achieved a fully funded position in 1989-90, 7 years ahead of target, the transport accident charge was increased by 5 per cent on 1 August 1991.

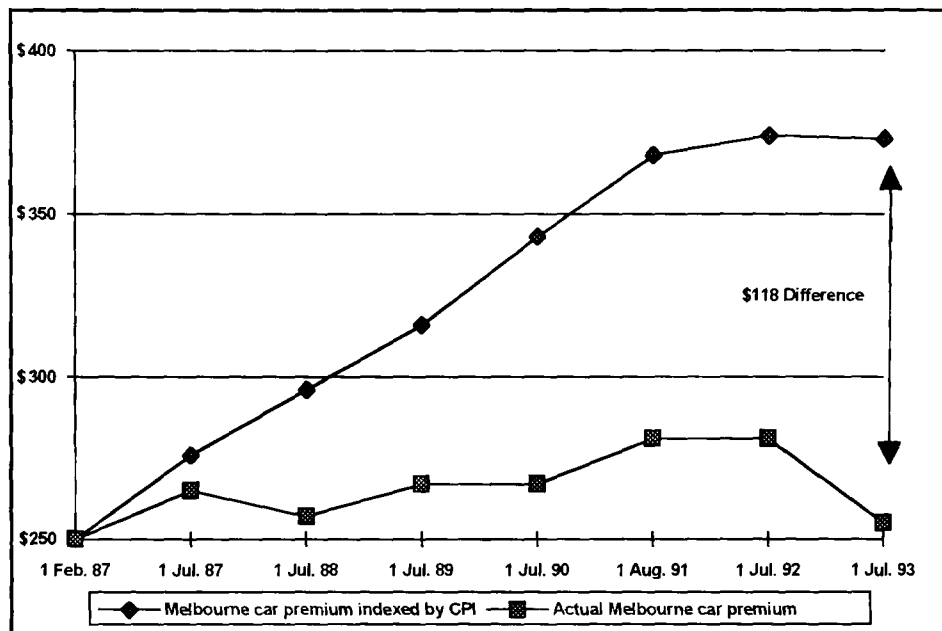
3.13.14 When commenting on the excellent financial performance of the Commission in the *Auditor-General's Reports on Ministerial Portfolios, April 1991 and May 1992*, audit expressed the view that the exceptionally strong financial position of the Commission should be reflected in the level of future transport accident charges to be levied on Victorian motorists. However, no relief has been provided to Victorian motorists by way of adjustment to the charge to take account of the Commission's financial strength. **Based on the level of the Commission's reserves and the Government's determined solvency level for the Commission of 20 per cent at 31 December 1993, audit calculated that each Victorian motorist has contributed \$400, equivalent to the payment of the transport accident charge for 1.8 years, to the Commission's surplus holdings.**

□ RESPONSE provided by Chief Executive Officer, Transport Accident Commission

Victorian motorists have enjoyed real financial relief through the non-indexation of TAC premiums, which is provided for in the legislation.

Significantly, while premiums have not increased with CPI, accident compensation payments and benefits have been fully indexed.

TAC PREMIUMS HAVE FALLEN SIGNIFICANTLY IN REAL TERMS



The cumulative saving to a Melbourne motorist due to the non-indexation of premiums is \$473. The Melbourne car premium is now \$118 below that which would have been charged if full indexation had always been applied.

In line with the improving financial position of the TAC, the TAC Board in June 1992 recommended premiums be reduced by 15 per cent. The then Government did not approve this recommendation.

However, the premium was reduced by 9 per cent upon the introduction of stamp duty on 1 July 1993.

Approximately \$1.5 billion of TAC reserves (or surplus holdings) accumulated largely through strong investment returns and effective management of claims, has been earmarked for State debt reduction for the benefit of all Victorians.

Strong investment performance

3.13.15 The Auditor-General's *Special Report No. 26, Investment Management, November 1993*, examined the investment performance of the Commission as part of a study of investment management by public bodies. The Report concluded that the investment achievements of the Commission had been excellent with returns over the past 5 years exceeding many large and medium-sized private sector organisations. The Commission achieved these returns while maintaining a very low risk profile.

3.13.16 The Commission's investment holdings at 30 June 1993 totalled \$4.2 billion. Income from investments for 1992-93 amounted to \$479 million and for the 6 months to 31 December 1993 income generated was \$610 million.

3.13.17 It can be seen that the Commission's strong financial position has been the outcome of a combination of its commendable management performance and the significant contributions made by Victorian motorists to its reserves.

Update on Farrow Group obligations

Buyback offer to bondholders

3.13.18 The major obligation included in the Farrow Group assets and liabilities transferred to the Commission on 15 January 1993 was the repayment of the Victorian Government Security Bonds totalling \$522 million. The bondholders were required to be paid by 3 instalments due in August 1993, 1994 and 1995.

3.13.19 In October 1993, the Premier announced that the Government had authorised the Commission to offer bondholders a cash settlement to redeem outstanding bonds which at that time had a nominal face value of \$338 million. Bondholders who accepted the offer would receive, during November and December 1993, cash at a small discount rate in lieu of the future instalments due in August 1994 and 1995.

3.13.20 By the deadline of 10 December 1993 set for responses from bondholders, 76 per cent or 27 400 of the total number of bondholders had accepted the Commission's settlement offer. These acceptances involved discounted payments by the Commission of \$176 million in respect of bonds with a nominal value of around \$189 million, and represented 56 per cent of the total nominal value of outstanding bonds.

3.13.21 An audit analysis of the offer arrangements indicated that, in financial terms, the offer was quite attractive to the bondholders. In fact, based on the Commission's current projected average return from investments and the discount rate applied to the buyback offer, **it has forgone income of around \$5.3 million as a result of the arrangements.** However, the Commission has advised audit that its offer was made in the knowledge that the forgone income would be more than offset by administrative savings and from the Commission's proactive work with the Farrow liquidator resulting directly in earlier and improved distributions.

3.13.22 There are other factors which also need to be taken into account when evaluating the merits of the buyback offer. Of particular importance in this regard is the fact that **the State's economy received a significant cash inflow immediately prior to the 1993 Christmas season, with emphasis in areas which had been adversely affected by the losses of the Farrow Group.**

Status of legal action

3.13.23 As mentioned in the Auditor-General's *Report on the Finance Statement, October 1993*, the non-withdrawable shareholders in the Farrow Group had appealed to the High Court of Australia against a previous Supreme Court ruling that these shareholders are not entitled to rank with depositors in the liquidation process.

3.13.24 On 10 November 1993, the High Court of Australia decided that those non-withdrawable shareholders who hold their shares by way of a direct allotment from an "issuing building society" (e.g. shares in Pyramid directly allotted by Pyramid) could not sue that society. The High Court did not expressly decide whether those shareholders who hold their shares by way of a transfer from a related building society could sue that Society.

3.13.25 The effect of this decision on distributions from the liquidator to the Commission depends firstly, on the number of shareholders who hold their shares by way of transfer and, secondly, on whether those transferee shareholders have tenable contractual claims against the "holding" society. These matters are yet to be resolved by the liquidator.

Retention of the Commission under State ownership

3.13.26 The *Auditor-General's Report on Ministerial Portfolios, May 1993*, referred to the Government's intention to privatise the commercial operations of the Commission as part of a restructure of the State's compulsory third party insurance industry.

3.13.27 On 6 December 1993, in a major statement on the Commission's future, the Treasurer announced that, following an extensive review process, the Government had determined to retain the Commission in State ownership and to instigate a restructure of the organisation. In the announcement, the Treasurer stated:

"On balance, the interest of the Victorian public and motorists is best advanced by the continuing public ownership of the Commission and retention of the basic features of the scheme.

"The restructuring will involve the establishment of 3 competing claims units within the Commission, the appointment of a Compulsory Third Party Commissioner to monitor the Commission and the establishment of a new Victorian funds management authority using the Commission's investment expertise as its nucleus.

"The reforms will result in improvements in claims management and customer service, while retaining the no-fault compensation scheme and the Commission's commercially-based accident prevention programs."

3.13.28 The Government's decision to utilise the Commission's investment expertise as the nucleus of the new funds management authority for the State, reflected the proven record of the Commission in successful investment management which, as indicated in an earlier paragraph, had been clearly recognised in the Auditor-General's *Special Report No. 26, Investment Management, October 1993*.

3.13.29 The Treasurer also announced that surpluses from the Commission would be used to repay State debt of \$1.5 billion. At the date of preparation of this Report, the manner in which the debt repayments are to occur was under consideration by the Government.

3.13.30 Audit has been advised by the Commission that the restructure process announced by the Treasurer is proceeding in consultation with the Office of State Owned Enterprises within the Department of the Treasury. The Commission expects the new internal structure to be in operation prior to 30 June 1994.

3.13.31 The Government's decision to utilise the Commission's finances to redeem State debt of \$1.5 billion follows some earlier decisions under which surplus funds of the Commission have been or will be drawn upon for the benefit of the State. These earlier decisions involve:

- transfer of the Government's financial obligations arising from the Farrow Group (\$521 million, present value terms at 30 June 1993);
- taxation of \$47 million accrued at 31 December 1993 under the Government's new tax equivalent system for Government Business Enterprises;
- dividend payment of \$92 million in 1992-93; and
- stamp duty payment of \$32 million covering the period 1 June to 31 December 1993 (estimated to be around \$60 million for the whole of 1993-94).

3.13.32 The above benefits at 31 December 1993 provided to the State from drawdowns on the Commission's finances, amount to \$2.2 billion (including the \$1.5 billion offset to State debt).

3.13.33 When viewed against the escalating strength of the Commission's financial position, the level of the compulsory transport accident charge levied on Victorian motorists may be regarded as excessive, particularly given that the Commission achieved a fully-funded status as far back as 1989-90. However, the above decisions of the Government mean that taxpayers as a whole now benefit from the Commission's financial growth.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

<i>Report</i>	<i>Subject</i>	<i>Status at date of preparation of this Report</i>
MATTERS RESOLVED OR ACTION COMMENCED		
TATTERSALL SWEEP CONSULTATION <i>Ministerial Portfolios, May 1993, pp. 303-4.</i>	Need for the Consultation to annually table audited financial statements in the Parliament.	The annual report for Tattersall Sweep Consultation was tabled in Parliament during the Spring Session of 1993.

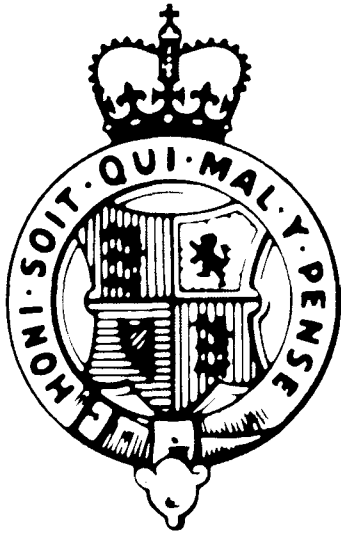
SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

<i>Entity</i>	<i>Financial year ended</i>	<i>Reporting to Parliament</i>	<i>Financial statements signed by entity</i>	<i>Auditor-General's report signed</i>
COMPLETED AUDITS				
Department of the Treasury	30 June 1993	31 Oct. <i>Annual Reporting Act 1983, s. 8.</i>	26 Oct. 1993	28 Oct. 1993
TREASURER				
Capital Works Authority (a)	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	27 Sept. 1993	28 Sept. 1993
Rural Finance Corporation	30 June 1993	30 Sept. <i>Rural Finance Act 1988, s.28.</i>	1 Sept. 1993	1 Sept. 1993
State Insurance Office (b)	30 June 1993	30 Sept. <i>State Insurance Office Act 1984, s.24.</i>	2 Sept. 1993	27 Sept. 1993
Tattersall Sweep Consultation	30 June 1993	31 Oct. <i>Tattersall Consultations Act 1958, s.8C.</i>	5 Oct. 1993	6 Oct. 1993
Transport Accident Commission	30 June 1993	30 Sept. <i>Transport Accident Act 1986, s.31.</i>	7 Sept. 1993	7 Sept. 1993
Treasury Corporation of Victoria (c)	6 months to 30 June 1993	30 Sept. <i>Treasury Corporation of Victoria Act 1992, s.38.</i>	17 Sept. 1993	21 Sept. 1993
Victorian Debt Retirement Fund	30 June 1993	30 Sept. <i>Annual Reporting Act 1983, s.9.</i>	15 Sept. 1993	27 Sept. 1993
Victorian Development Fund	30 June 1993	30 Sept. <i>Public Account Act 1958, s.7G.</i>	16 Sept. 1993	28 Sept. 1993
Victorian Public Authorities Finance Agency (c)	6 months to 31 Dec. 1992	30 Sept. <i>Victorian Public Authorities Finance Act 1984, s.14.</i>	17 Sept. 1993	21 Sept. 1993

(a) Abolished on 31 January 1994.

(b) The wholly-owned entities of SIO Services Pty Ltd and SIO Superannuation Pty Ltd were sold to the GIO group of companies effective 31 July 1992.

(c) The Treasury Corporation of Victoria was established on 1 January 1993 as the successor-in-law to the Victorian Public Authorities Finance Agency.



Part 4

Broad Scope Issue

Part 4.1

Financial Reporting in the Victorian Public Sector

KEY FINDINGS

- The Department of Finance has played a pivotal role in facilitating improvements in the State's financial reporting practices and in improving the timeliness of financial reporting to Ministers and the Parliament.
Paras 4.1.7 to 4.1.15
- There still remain several areas where the Department of Finance needs to provide further guidance to entities to enhance the standard of public sector financial reporting.
Paras 4.1.16 to 4.1.27
- With the introduction of accrual accounting for government departments, the Department of Finance should ensure that more definitive policies are formulated in relation to the valuation of non-current assets.
Para. 4.1.30

FINANCIAL REPORTING IN THE VICTORIAN PUBLIC SECTOR

4.1.1 Financial reporting in the public sector is part of the process through which the Government discharges its accountability responsibilities to the Parliament and the general community in relation to its management and stewardship of publicly-owned resources. It also provides a basis for decision-making in relation to resource allocation and financial management matters.

4.1.2 Given the importance of financial reporting in the overall financial management of the State, it is incumbent upon preparers of financial reports to ensure that the information which is conveyed to users in the reports is complete, free of error and provided to users in a timely manner. Furthermore, it is the responsibility of the Government, via the central agency responsible for regulating public sector financial reporting, namely the Department of Finance, to provide guidance to public sector organisations on the application and interpretation of accounting standards, regulations and policy statements impacting upon financial reporting. Accordingly, the development of accounting and financial reporting requirements and related guidance statements by the Department are critical in ensuring effective financial accountability in the public sector.

4.1.3 In recent years, there have been significant developments in Australia, and countries such as New Zealand, aimed at enhancing public sector financial accountability by improving the standard of financial reporting. One of the key initiatives which has brought about such improvement has been the introduction of commercially-based accounting principles, otherwise referred to as *accrual accounting*, to government departments. The Department of Finance is currently in the process of facilitating the progressive implementation of accrual accounting within government departments. The Department's program, which was commenced in October 1991, requires departments to progressively prepare supplementary accrual financial statements in addition to their cash-based financial statements.

OVERALL CONCLUSION

4.1.4 The Department of Finance has played a pivotal role in facilitating improvements in the State's financial reporting practices through the development and issue of various guidance releases, policy statements and accounting manuals. In addition, the Department is committed to improving the timeliness of financial reporting to Ministers and the Parliament.

4.1.5 However, there still remain several areas where the Department needs to provide further guidance to entities to enhance the standard of public sector financial reporting. These include:

- accounting for superannuation liabilities;
- consolidated financial reporting;
- disclosure of related party information; and
- assessing ongoing financial viability of entities.

4.1.6 Finally, with the recent introduction of *accrual accounting* for government departments, the Department of Finance needs to ensure that more definitive policies are formulated in relation to non-current asset valuation methodologies, so that departments are able to effectively account for such assets.

□ **RESPONSE** provided by Acting Secretary to the Department of Finance

Audit's comments on the improvements in financial reporting in the Victorian public sector are noted. Efforts to achieve further improvements, in particular in relation to issues raised by audit, will continue.

Timeliness of reporting to the Parliament

4.1.7 An important determinant of the effectiveness of financial reporting is the timeliness of information which is conveyed to users. Financial information may lose relevance if there are undue delays in providing such information to users, that is, Parliament and the public.

4.1.8 The *Annual Reporting Act 1983*, as well as enabling legislation for public sector entities, prescribe the various statutory reporting deadlines for the presentation by entities of their annual reports to their Ministers, who are in turn required to table these reports in the Parliament. Some of the more significant statutory reporting deadlines are shown in Table 4.1A below.

TABLE 4.1A
STATUTORY REPORTING DEADLINES

<i>Type of entity</i>	<i>Financial year ended</i>	<i>Statutory reporting deadline for reporting to Ministers</i>
Departments	30 June	31 October
Business undertakings	30 June	30 September
Contributed income sector bodies -		
Universities and colleges	31 December	30 April
Health bodies (including public hospitals)	30 June	31 October
Other entities	30 June	30 September
Superannuation schemes	30 June	30 November

4.1.9 Government trading enterprises, otherwise referred to as *business undertakings*, have 3 months after their balance date to complete and forward annual reports to their Ministers. Statutory reporting periods for other entities vary depending on the nature of the entity. For example, departments and *contributed income sector* bodies which mainly comprise public hospitals, universities and colleges have a period of 4 months after balance date to present their annual reports to their Ministers.

4.1.10 There has been a significant improvement in the timeliness of reporting to Parliament in the 1992-93 financial year. In particular, there was a notable improvement within the *business undertakings* sector. Departments and public hospitals were on average, able to report to Parliament in a more timely manner than in previous years. These improvements mainly resulted from a decision by the Minister for Finance in March 1993, to limit the granting of extensions beyond the ministerial reporting deadline. As a result, only 7 extensions have been granted in respect of the 1992-93 financial year as of 31 March 1994. **The Minister is to be commended for his strong stance on this matter.**

4.1.11 The main reasons why entities have sought extensions in the past included:

- incomplete or unsatisfactory financial statements being submitted to audit; and
- difficulties experienced by the entities in the preparation of their financial statements.

4.1.12 While acknowledging the improvement in performance to date, it is important that the Department of Finance maintains its efforts to ensure that all public sector entities finalise annual financial reports on a timely basis, consistent with their statutory reporting obligations.

□ *RESPONSE provided by Acting Secretary to the Department of Finance*

The Department of Finance will continue to pursue timeliness of reporting to Parliament as an issue of great importance.

Accounting policies and practices within the Victorian public sector

4.1.13 Public sector reporting entities are required to prepare financial statements which comply with Australian Accounting Standards, as well as the requirements of the *Annual Reporting Act 1983* and other relevant legislation.

4.1.14 In previous Auditor-General *Reports on Ministerial Portfolios*, audit has commented on the adequacy of accounting practices in the Victorian public sector and has drawn attention to the need for the Department of Finance to be pro-active in the development of accounting policies for the public sector.

4.1.15 Recently, there have been significant efforts by the Department of Finance and public sector entities in general, to improve the standard of financial reporting. For example, the Department has provided guidance to entities on various financial reporting issues such as the valuation of library collections by universities and the implementation of accrual accounting by government departments. However, there are still a number of areas which require attention, such as those outlined below.

Asset recording, reporting and valuation

4.1.16 A key component of meaningful accrual-based financial information is complete and accurate non-current asset information, based on adequate records and independent valuations. Over the past 5 years, the state of asset recording and reporting by some public sector entities, such as public hospitals, water bodies and certain entities in the Arts sector has generally been unsatisfactory because of incomplete asset records and the use of subjective valuations. This has been the case particularly in relation to land and buildings and *vested assets*, such as Crown land and heritage assets, which include the State's museum, library and art collections. In addition, departments have not been required to report non-current asset values in their cash-based financial statements.

4.1.17 Of approximately 530 entities subject to audit, 146 audit reports were qualified in 1992-93 (188 in 1991-92) due to inadequacies in asset recording, reporting and valuation. Of this number, 95 per cent of the qualified audit reports issued in relation to this matter related to entities in the water and public hospital sectors.

4.1.18 In 1994, both the Department of Conservation and Natural Resources and the Department of Health and Community Services, after having consulted with the Department of Finance, have initiated action to improve deficiencies in asset recording, reporting and valuation among water bodies and public hospitals. To this end, the Department of Conservation and Natural Resources has issued a paper entitled *Current Directions in Asset Management Information* to assist water bodies with the reporting and valuation of assets. In addition, the Department of Health and Community Services has strongly encouraged all public hospitals to obtain independent valuations from the Valuer-General for their land and buildings.

4.1.19 In the 1993 Auditor-General's *Report on the Finance Statement*, comment was made on the delay associated with the implementation of the Department of Finance's Accounting Policy Statement APS4 *Recording and Reporting of Non-Current Physical Assets*, which was issued in August 1991 and as yet has not been implemented. In May 1993, the Department issued a guidance release on this subject to government departments only and is now developing a technical information paper dealing with *Valuation Methodologies for Non-Current Physical Assets*.

4.1.20 Given the importance of complete asset information for financial reporting purposes and the deficiencies that currently exist in this area, it is important that the Department of Finance issues comprehensive guidance and direction on asset valuation to all public sector entities as soon as possible.

□ **RESPONSE** provided by Acting Secretary to the Department of Finance

The Department of Finance has taken action over the past year to address the issue of asset valuation by developing and recently releasing as an exposure draft, Technical Information Paper No. 2, "Valuation Methodology for Non-Current Physical Assets". The release of this paper in its final form subsequent to the exposure draft period will provide departments with a framework to undertake asset valuations which will be consistent across the budget sector.

Non-consolidation

4.1.21 The need for consolidated financial reports of entities which are financially and operationally interdependent has prompted audit comment in recent years. Where one entity is directly or indirectly controlled by another, then their financial transactions should be reported by way of consolidated financial statements in accordance with Australian Accounting Standard AAS 24 *Consolidated Financial Reports*. This standard was given mandatory status in 1991 under the *Annual Reporting Act 1983*.

4.1.22 In certain cases, particularly where trust funds and companies have been established, there has been a reluctance by some public sector entities to disclose the financial affairs of their controlled entities. Usually, these entities receive significant public resources, therefore it is important that public accountability is not diluted by the failure to report their financial activities in a consolidated format.

4.1.23 Despite the fact that the non-consolidation of the financial statements of certain trusts and companies has been reported on several occasions in previous Auditor-General's Reports to Parliament, this area still remains a continuing problem, particularly in the post-secondary education sector.

4.1.24 Audit is of the view that the Department of Finance should take a proactive stance on this issue, particularly given that Australian Accounting Standard AAS 24 and the *Annual Reporting Act 1983* have required the preparation of consolidated financial reports for several years.

□ **RESPONSE** provided by Acting Secretary to the Department of Finance

The issue of control in the context of consolidated financial reporting is one which has given rise to considerable debate in both the public and private sectors. The relevant standard (Australian Accounting Standard - AAS24) is acknowledged by the Department of Finance. This standard is incorporated in the relevant Annual Reporting Regulations.

Recognition of unfunded superannuation liabilities

4.1.25 In previous Auditor-General's *Reports on Ministerial Portfolios*, audit has commented on the disclosure of obligations by public sector entities for superannuation entitlements. In those Reports, audit has espoused the view that, when accounting for superannuation in the financial statements of an employing entity, it is necessary to recognise the full extent of the liability that accrues to that entity.

4.1.26 The majority of public sector entities continue to report their unfunded superannuation liabilities by way of note disclosure only in their financial statements. While this form of disclosure is required for those entities reporting in accordance with the *Annual Reporting Act 1983*, such disclosure does not give recognition to these liabilities in the balance sheet and therefore, the true financial position of the reporting entity is not fully disclosed.

4.1.27 The public sector superannuation reforms introduced by the Government in October 1993, place the onus for the provision of superannuation contributions for employees on to the employing agency. As part of this reform process, the Government has clearly indicated an intention to move towards a higher and more stable level of funding for the State's superannuation schemes. **Accordingly, this stance would suggest that it is highly appropriate that the employer's share of any unfunded superannuation liabilities be recognised in the balance sheet of reporting entities.**

□ RESPONSE provided by Acting Secretary to the Department of Finance

The Department of Finance recommends reporting of liabilities for unfunded superannuation benefits via a note to the financial statements. This approach is based upon the view that superannuation is a central government issue rather than an entity specific issue. This treatment is consistent with the treatment outlined in the recently released Australian Accounting Standard - AAS30 "Accounting for Employee Entitlements". The Department of Finance will continue to monitor its policy position in regard to disclosure of unfunded superannuation.

□ FURTHER AUDIT COMMENT

While AAS30 requires disclosure of a range of relevant matters, including certain disclosures about an employer's superannuation obligations, the Standard does not specify recognition and measurement requirements in relation to an employer's superannuation obligation to employees. The Public Sector Accounting Standards Board and the Australian Accounting Standards Board are continuing their consideration of the issues relating to the recognition and measurement of an employer's superannuation obligations. The Boards have indicated that before completing their deliberations, they intend to hold a public hearing to provide further opportunity for input from interested parties. The Boards have further indicated that following analysis of responses received at the public hearing, they will then finalise accounting standards for the recognition and measurement of an employer's superannuation obligations and amend AAS30 accordingly.

Accrual accounting by government departments

4.1.28 In October 1991, the Department of Finance commenced the introduction of an accrual accounting framework for government departments, with 6 departments initially selected as part of this program. In 1992-93, the Department re-assessed this program and decided to extend it with a 3 year staged approach for implementation across all departments. The objective of the program is to ensure that all departments will ultimately produce accrual-based financial reports in a form suitable for audit by the 1995-96 financial year.

4.1.29 The Department of Finance has held regular meetings with departmental finance managers to assist and advise them on the implementation of this initiative. The Department has also conducted a number of training courses for finance managers and their staff. **Audit recognises and commends the Department of Finance's positive efforts in this area.**

4.1.30 The Department of Finance has issued a series of *Accrual Guidance Releases* on different aspects of accrual accounting and has also developed an accrual accounting manual to assist user departments. However, audit is concerned that the Department's *Accrual Guidance Release* dealing with valuation and reporting of non-current assets by government departments, has not adequately addressed matters associated with the valuation of non-current assets. This Release recommends that departments place a **notional** current value on all non-current assets in the first year they produce financial statements prepared on an accrual basis and within 5 years all non-current assets should be appropriately valued. As noted earlier in this Report, risks associated with subjective deemed valuations may result in inadequate financial information being reported. **The Government needs to direct resources towards an appropriate independent valuation strategy, which will add greater credibility to non-current asset values included within supplementary accrual financial statements.**

Audit committees

4.1.31 For a number of years, audit has encouraged public sector entities, where practical, to establish audit committees. Such committees, should comprise board members or independent persons with appropriate expertise, whose role it is to liaise with external audit, direct the entity's internal audit function and provide an effective means of feedback to the board in relation to financial matters, including issues raised in audit reports.

4.1.32 The importance of the role and function of audit committees has been recognised by the Government. Major public bodies have been pro-active in establishing audit committees and from June 1993, government departments were also required to establish such committees following the introduction of the Audit (Financial Management) Regulations 1993. These Regulations, *inter alia*, require that:

"The Department Head must establish and maintain an audit committee to oversee and advise him or her on matters of accountability and internal control affecting the operations of the department".

4.1.33 Prior to the introduction of the above Regulations, the Department of Finance, in May 1993, issued a guidance paper entitled *Audit Committees: Guidelines on Role, Functions and Responsibilities*, outlining the manner in which audit committees should be established and operated within government departments. The Department of Finance is currently monitoring departments' compliance with these Guidelines and Regulations.

4.1.34 **Audit commends the Government's initiatives in this area, and looks forward to the results of the Department of Finance's compliance review as a mechanism to further enhance the standard of public financial management.**

□ **RESPONSE** provided by Acting Secretary to the Department of Finance

The Department of Finance will continue to monitor compliance of departments with audit committee guidelines.

Emerging issues

Related party transactions

4.1.35 In recent years, there has been a noticeable trend in the public sector towards the "corporatisation" of government-owned business undertakings. Given that a considerable number of public sector board members are now being selected from private organisations which may have business dealings with government-owned business undertakings, audit is of the view that the same standards of disclosure and public accountability expected of company directors and executives in the private sector, should be applied to public sector board members. At present, most public sector entities are constituted under specific State legislation and consequently, audit is concerned that currently, Australian Accounting Standard AAS 22 *Related Party Disclosures* is not directly applicable to those entities.

4.1.36 During 1992-93, the Auditor-General wrote to the Australian Accounting Research Foundation and suggested that the Public Sector Accounting Standards Board, should consider extending the applicability of AAS 22 to cover public sector reporting entities. The Auditor-General also suggested to the Department of Finance that mandatory status be given to AAS 22 under the *Annual Reporting Act* 1983. Both the Foundation and the Department have responded and indicated they will consider the Auditor-General's suggestions. To date, only one major business undertaking, namely the Totalizator Agency Board, has disclosed significant related party information and this occurred for the first time in its 1992-93 financial statements.

4.1.37 As an interim measure, prior to any amendment to AAS 22 by the Public Sector Accounting Standards Board, consideration should be given by the Department of Finance to requiring public sector entities to disclose *related party* information in their financial statements in 1993-94.

RESPONSE provided by Acting Secretary to the Department of Finance

It is acknowledged that Australian Accounting Standard - AAS22 requires disclosure of related party transaction information by private sector reporting entities, however, application of the standard by public sector entities is not required. Accordingly, the Department of Finance position in not making related party transaction disclosures mandatory for Victorian public sector reporting entities is consistent with Australian Accounting Standards.

Financial viability of entities

4.1.38 The assessment of the financial viability of organisations is an area which has come under much attention in the corporate sector since the late 1980s. The need to assess an entity's ability to operate in a viable manner and continue as a *going concern* is now also an ever-present consideration in the public sector.

4.1.39 The Victorian Government is encouraging public sector entities to become more self-sufficient in their financial and operating activities and thus, less reliant on government financial assistance. For example, the introduction in 1993 of *case-mix funding* for public hospitals, whereby government funding is allocated on the basis of services provided, requires hospital management to create a more performance oriented and competitive environment for public hospital services. Similar reforms are being introduced in other sectors, such as the provision of higher education services by universities and colleges.

4.1.40 In light of such government strategies, public sector entities will not automatically receive set levels of government financial assistance, but funding will be linked to the level of outputs achieved. In this context, audit has directed its attention to an assessment of the ongoing financial viability of a number of entities. In 1992-93, qualified audit opinions were expressed on the financial statements of 3 entities, on the basis of material uncertainty in relation to their ability to continue to operate as viable *going concerns*.

4.1.41 While audit is required to consider such issues as part of the annual audit process, the Government should take action to identify those entities which pose a high risk to the State and ensure that an appropriate risk management strategy for such entities is developed.

□ *RESPONSE provided by Acting Secretary to the Department of Finance*

It is acknowledged that this is an issue which will require consideration by government. Accordingly, the Department of Finance is proposing to develop guidelines to assist agencies to monitor the financial viability of organisations that are government-funded.

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